ACCA

FR

Financial Reporting

Integrated Workbook

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This document references IFRS® Standards and IAS® Standards, which are authored by the International Accounting Standards Board (the Board), and published in the 2023 IFRS Standards Red Book.

Integrated Workbook Icons

Additional question practice/reading

British Values

Definition

Exam Technique Point

Example

Illustration

Important calculation

Key Point

Overview

Target

PER requirements

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Financial Reporting (FR)

L7 Knowledge, Skills and Behaviours

As per the Level 7 Accountancy/Taxation Professional Apprenticeship standard, you will need to demonstrate that you have the necessary Knowledge, Skills and Behaviours.

The list below shows the relevant knowledge, skills and behaviours that you will have demonstrated whilst studying for this unit. We have also linked these to relevant examples in the Integrated Workbook.

For qualification only students, it is also useful to understand which professional skills and behaviours you are developing throughout this unit.

Knowledge	An accountancy or taxation professional will be able to:
Business acumen	Demonstrate knowledge of key business objectives and measurements of success.
Financial information	Prepare, analyse and interpret an organisation's financial information (both for internal and external purposes), as relevant to their role.
Legislation	Understand, interpret and apply the legislation, standards and principles that apply to Standards and their role. This may include, but not be limited to, accounting standards, auditing Principles standards, taxation legislation, ethical codes and internal principles adopted by an organisation.
Strategic business management and governance	Apply their judgement and make sustainable business decisions (including recommendations for good governance) using financial and non-financial information. Support strategic decision making with meaningful financial analysis and project appraisal. Present a balanced conclusion, with supporting evidence, which includes internal and external factors.

Financial Reporting

Skills	An accountancy or taxation professional will be able to:
Building relationships	Build trusted and sustainable relationships with individuals and organisations. Consistently support individuals and collaborate to achieve results as part of a team.
Business insight	Influence the impact of business decisions on relevant and affected communities based on an appreciation of different organisations and the environments in which they operate.
Communication	Communicate in a clear, articulate and appropriate manner. Adapt communications to suit different situations, individuals or teams.
Ethics and integrity	Identify ethical dilemmas, understand the implications and behave appropriately. Understand their legal responsibilities, both within the letter and the spirit of the law, as well as be aware of the procedures for reporting concerns over potentially unethical activities.
Leadership	Take ownership of allocated projects and effectively manage their own time and the time of others. Demonstrate good project management skills to deliver high quality work within the appropriate timeline. Act as a role model and motivate others to deliver results.
Problem solving and decision making	Evaluate information quickly and draw accurate conclusions. Assess a problem from multiple angles to ensure all relevant issues are considered. Gather the appropriate facts and evidence in order to make decisions effectively.

L7 Knowledge, Skills and Behaviours

Behaviours	An accountancy or taxation professional will be able to:
Adds Value	Anticipate an individual's organisations future needs and requirements. Identify opportunities that can add value for the individual and organisation.
Continuous improvement	Take responsibility for their own professional development by seeking out opportunities that enhance their knowledge, skills and experience.
Flexibility	Adapt approach to assist organisations and individuals to manage their conflicting priorities as circumstances change.
Professional scepticism	Apply a questioning mind to conditions which may indicate a possible misstatement of financial information due to error or fraud.

Financial Reporting

Chapter 1

Published financial statements

Outcome

By the end of this session you should be able to:

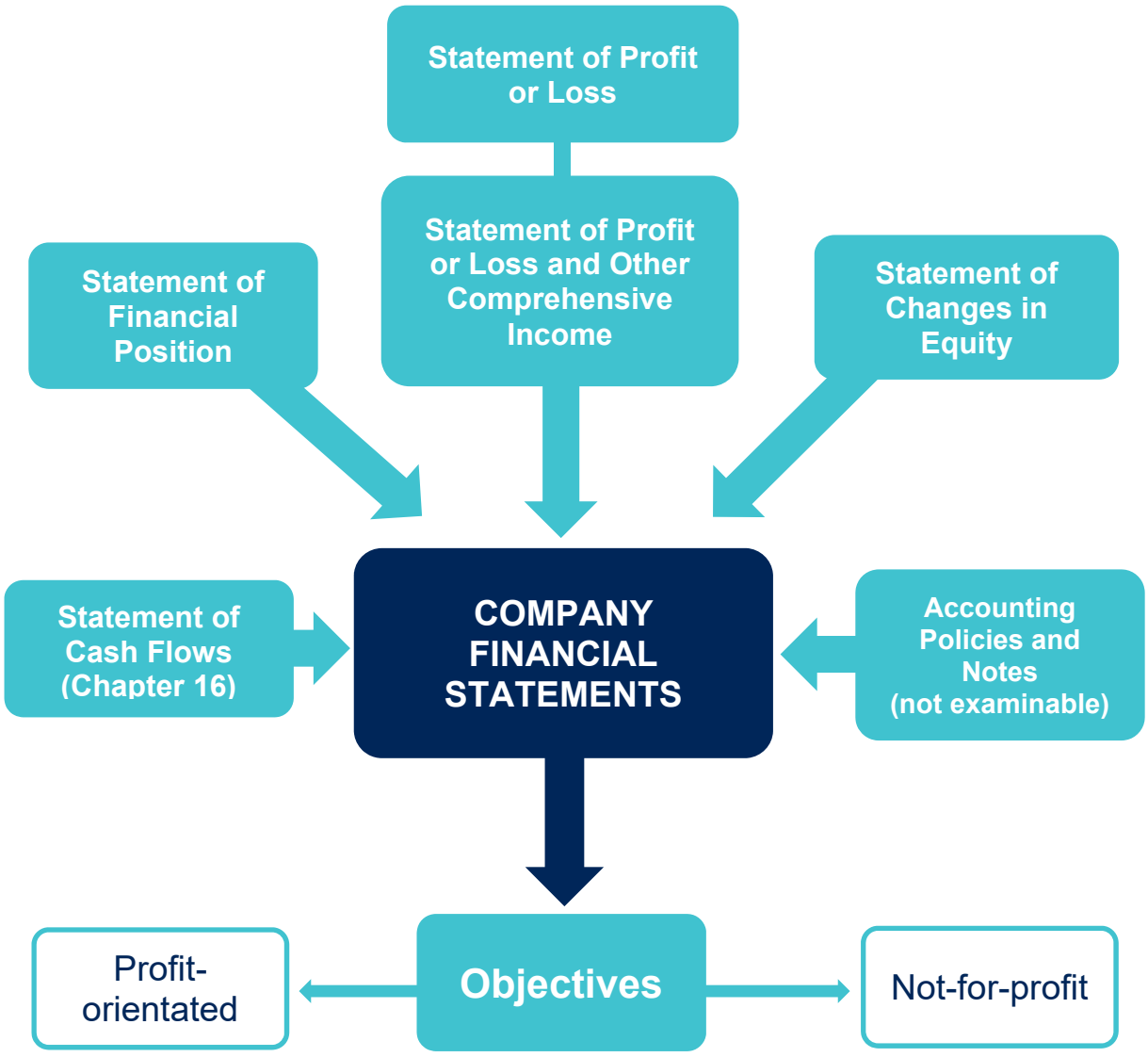
- prepare an entity's financial statements in accordance with prescribed structure
- prepare and explain the statement of changes in equity

and answer questions relating to these areas.

PER

One of the PER performance objectives (PO7) is to prepare external financial reports. You take part in preparing and reviewing financial statements – and all accompanying information – and you do it in accordance with legal and regulatory requirements. Working through this chapter should help you understand how to demonstrate that objective.

Overview


Statement of Profit or Loss
Statement of Profit or Loss and Other Comprehensive Income
Statement of Financial Position
Statement of Changes in Equity
Statement of Cash Flows (Chapter 16)
COMPANY FINANCIAL STATEMENTS
Accounting Policies and Notes (not examinable)
Objectives
Profit-orientated
Not-for-profit

1 Preparation of financial statements for companies

A complete set of financial statements comprises:

- **statement of financial position** – assets, liabilities and equity
- **statement of profit or loss (and other comprehensive income)** – income and expenditure (and unrealised gains and losses)
- **statement of changes in equity** – movement in all components of equity
- **statement of cash flows** – cash movements during the period (see Chapter 16 for detail)
- **accounting policies and explanatory notes** – explains how financial statements have been produced.

Notes

2 Format of financial statements

2.1 Statement of financial position – recommended format

XYZ Statement of financial position as at 31 March 20X9

	$	$
Assets		
Non-current assets		
	X	
	X	
	X	
	———	X
Current assets		
	X	
	X	
	X	
	———	X
		———
		X
		———
Equity and liabilities		
Equity		
	X	
	X	
	X	
	———	X
Non-current liabilities		
	X	
	X	
	X	
	———	X
Current liabilities		
	X	
	X	
	X	
	———	X
		———
		X
		———

Notes

2.2 Statement of profit or loss and other comprehensive income – recommended format

XYZ Statement of profit or loss and other comprehensive income for the year ended 31 March 20X9

	$
Revenue	X
Cost of sales	(X)
Gross profit	X
Distribution costs	(X)
Administrative expenses	(X)
Profit from operations	X
Finance costs	(X)
Investment income	X
Profit before tax	X
Income tax expense	(X)
Profit for the year	X
Other comprehensive income	X
Total comprehensive income	X

Notes

2.3 Statement of changes in equity – recommended format

XYZ Statement of changes in equity for the year ended 31 March 20X9

	Share capital	Share premium	Revaluation surplus	Retained earnings	Total equity
	$	$	$	$	$
Balance at 1 April 20X8	X	X	X	X	X
Prior year adjustment: see chapter 8				(X)	(X)
Restated balance	X	X	X	X	X
Total comprehensive income			X	X	X
Issue of share capital	X	X			X
Dividends				(X)	(X)
Transfer to retained earnings: see chapter 2			(X)	X	–
Balance at 31 March 20X9	X	X	X	X	X

You need to learn these pro-forma layouts.

Notes

Not-for-profit and public sector entities

3.1 Differences between profit-orientated and not-for-profit entities

Financial aims

Accountability

Sources of finance

Notes

Example 1

Trial balance question

The trial balance of Grey for the year ended 31 December 20X2 is shown below. Various year-end adjustments are required and these are detailed below the trial balance.

	Debit	Credit
	$000	$000
Sales		95,500
Cost of sales	62,561	
Distribution costs	5,175	
Administrative expenses	6,560	
Dividends received		750
Interest received		150
Interest paid	600	
Property, plant and equipment at 1 January 20X2	34,765	
Inventory at 31 December 20X2	7,516	
Trade receivables	18,673	
Short-term investment	6,500	
Ordinary $1 share capital		15,000
Share premium		2,000
Revaluation surplus 1 January 20X2		5,000
Retained earnings 1 January 20X2		5,175
6% loan repayable in 20X9		10,000
Dividends paid	650	
Trade payables		8,675
Bank		750
	143,000	143,000

Notes

(i) Land included in property, plant and equipment at a carrying amount of $15,000,000 is to be revalued at 31 December 20X2 to $20,000,000.

(ii) Depreciation of $11,250,000 is to be charged to cost of sales.

(iii) The tax charge in respect of the year to 31 December 20X2 is estimated to be $2,290,000.

Required:

Prepare Grey's statement of profit or loss and other comprehensive income, statement of changes in equity and statement of financial position for the year ended 31 December 20X2. (Use the blank pro-formas provided and work to the nearest $000.)

Through your preparation of these financial statements, this example allows you to demonstrate your knowledge of financial information.

Notes

Answer pro-forma

Grey statement of profit or loss and other comprehensive income for the year ended 31 December 20X2

	$000
Revenue	
Cost of sales	
Gross profit	
Distribution costs	
Administration expenses	
Profit from operations	
Finance costs	
Investment income	
Profit before tax	
Income tax expense	
Profit for the year	
Other comprehensive income	
Total comprehensive income	

Notes

Grey statement of changes in equity for the year ended 31 December 20X2

	Share capital	Share premium	Retained earnings	Revaluation surplus	Total equity
	$000	$000	$000	$000	$000
Balance at 1 Jan 20X2					
Total comprehensive income					
Dividends					
Balance at 31 Dec 20X2					

Grey statement of financial position as at 31 December 20X2

	$000	$000
Non-current assets		
Property plant and equipment		
Current assets		
Inventory		
Receivables		
Investments		

Notes

Equity

Share capital

Share premium

Retained earnings

Revaluation surplus

Non-current liabilities

6% Loan

Current liabilities

Payables

Taxation

Bank

Notes

Questions

Chapter 2

Tangible non-current assets

Outcome

By the end of this session you should be able to:

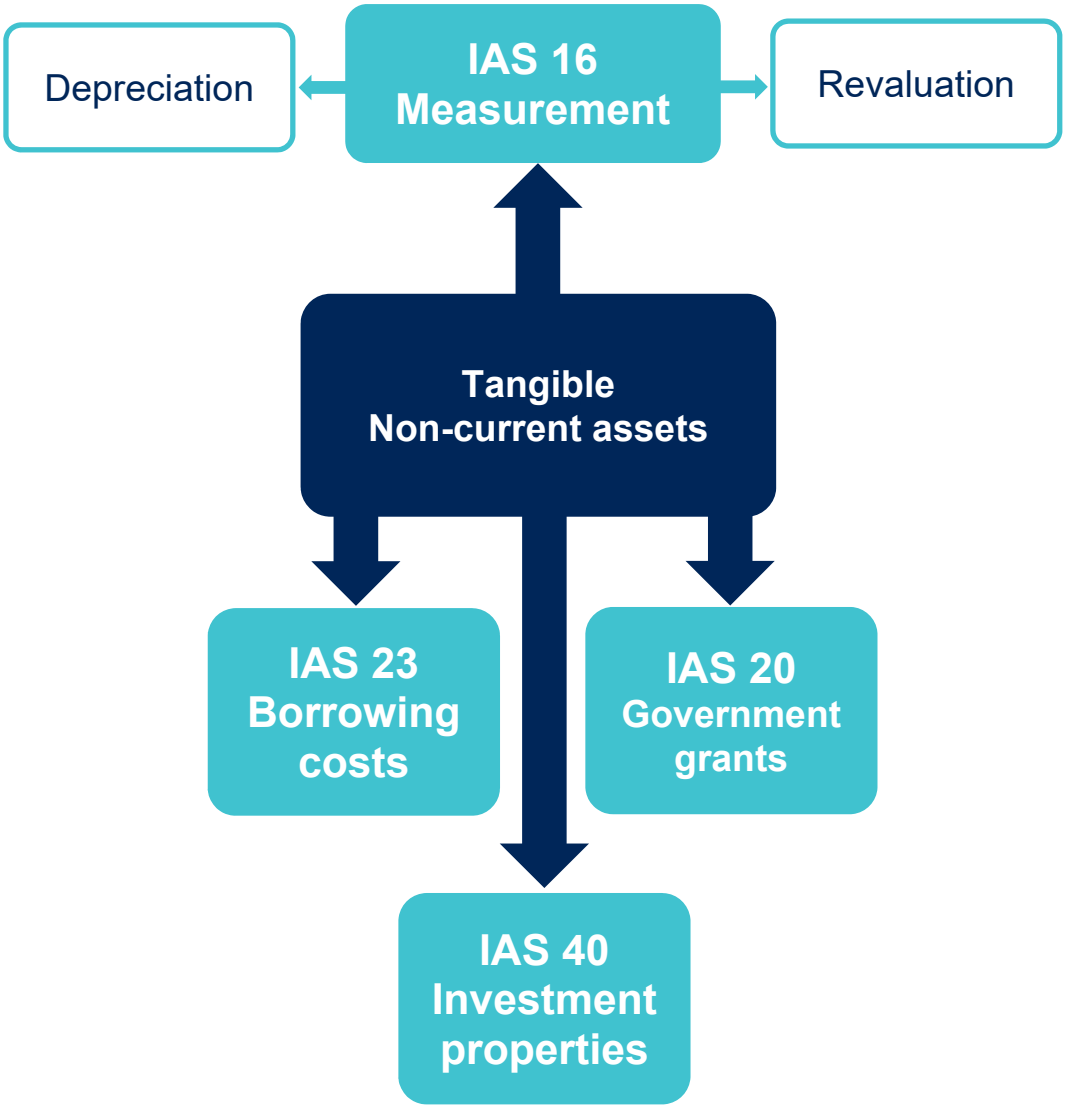
- define and compute the initial measurement of a non-current asset
- identify subsequent expenditure that may be capitalised
- explain the requirements of IAS 16 in relation to revaluation
- account for revaluation and disposal gains and losses for non-current assets
- calculate depreciation based on the cost and revaluation model
- account for government grants
- account for investment properties

and answer questions relating to these areas.

PER

One of the PER performance objectives (PO6) is to record and process transactions and events. You use the right accounting treatments for transactions and events. These should be both historical and prospective – and include non-routine transactions. Working through this chapter should help you understand how to demonstrate that objective.

Overview


Depreciation
IAS 16
Measurement
Revaluation
Tangible
Non-current assets
IAS 23
Borrowing
costs
IAS 20
Government
grants
IAS 40
Investment
properties

1 Recognition and initial measurement

1.1 Recognition

Property plant and equipment should be recognised as an asset when there is

-
-

1.2 Initial measurement

Property, plant and equipment should initially be measured at cost. Cost should include all directly attributable costs necessary to bring the asset into use, and could include:

-
-
-
-

Note: Training costs can never be capitalised as an asset.

Notes

Illustration 1

End-of-life costs

As a condition of being granted a 10-year mining licence, an entity is required to landscape the area at the end of the licence period at an estimated cost of $3 million. The entity has a cost of capital of 6%.

The landscaping cost is initially recognised as an asset at a value of $1.68 million ($3m × $1/1.06^{10}$) together with a provision for the same amount.

Dr Asset Cr Provision

The asset is then depreciated over 10 years on a straight line basis at $168,000 per annum ($1.68m/10 years).

Dr Depreciation (SPL) Cr Asset

The liability is increased each year by unwinding the discount, charging a finance cost at 6% per annum.

Dr Finance cost (SPL) Cr Provision

So after one year the liability would be:

	$000
Initial value	1,680
Interest at 6%	101
Liability at end of year 1	1,781

This liability would continue to increase until at the end of year 10 it would have increased to the estimated cost of $3 million.

Notes

1.3 Subsequent expenditure

Subsequent expenditure should only be capitalised if it

-
-
-

Illustrations and further practice

Notes

2 Depreciation

2.1 Definition

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

Illustration 2

Depreciable amount

An entity purchases an asset at a cost of $80,000. The asset has an expected useful life of 5 years and a residual value of $5,000 at current prices.

The depreciable amount is $80,000 – $5,000 = $75,000

2.2 Methods of depreciation

-
-
-

Notes

Illustration 3

The depreciable amount of $75,000 calculated above will be charged as an expense over the useful life of the asset.

On a straight-line basis this would give an annual charge of $75,000/5 = $15,000.

Using the reducing balance method would still require $75,000 to be charged as an expense over 5 years, calculating an appropriate percentage to do so.

Illustration 4

Revision of useful life

An asset was purchased for $100,000 on 1 January 20X5 and straight-line depreciation of $20,000 per annum is being charged (five-year life, no residual value). At 1 January 20X7 the annual review of asset lives was undertaken and for this particular asset, the remaining useful life was estimated at eight years.

What is the depreciation charge for the year ended 31 December 20X7?

Solution

The depreciation charge for current and future years will be calculated:

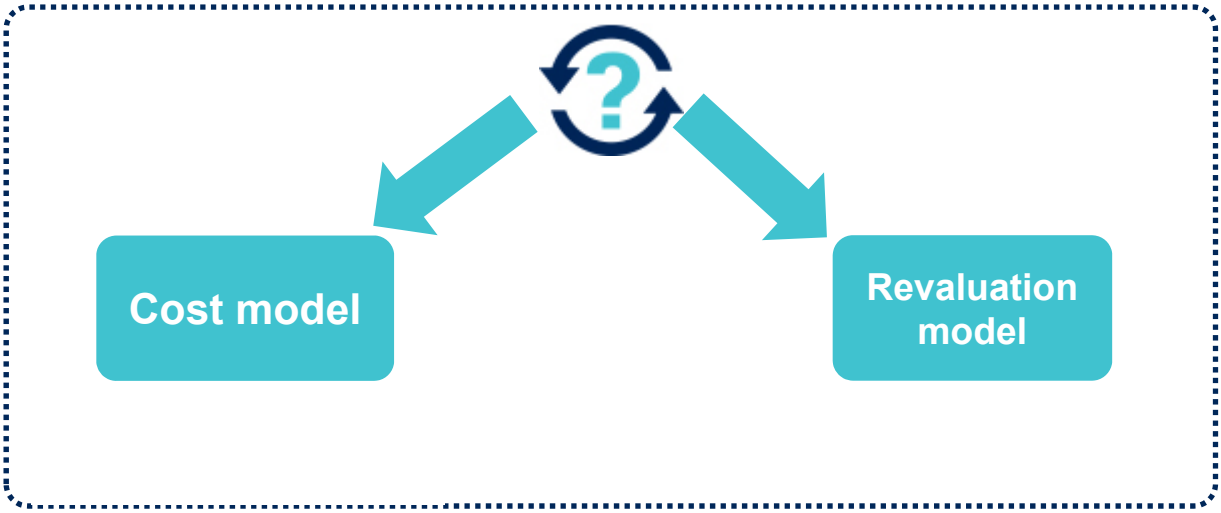
Carrying amount as at 31 December 20X6

Remaining useful life as at 1 January 20X7

Annual depreciation charge

3 Revaluations

3.1 IAS 16 Choices



3.2 Impact of revaluation

- All assets in same class to be revalued
- Once revalued, revaluations must be kept up to date
- Subsequent depreciation will be based on the new value and remaining useful life.

3.3 Accounting for revaluation

- Restate asset cost to new value
- Remove accumulated depreciation
- Revaluation gains are recognised within other comprehensive income and credited to revaluation surplus
- Revaluation losses are charged as an expense

3.4 Revaluation surplus

- The revaluation surplus is a capital reserve, and therefore non-distributable.
- The revaluation surplus cannot have a debit balance.
- There is no offset permitted between assets, i.e. a loss on one asset cannot be offset against a gain on another.

3.5 Annual reserves transfer

IAS 16 permits an annual transfer to be made from the revaluation surplus to retained earnings to offset the additional depreciation charged as a result of the revaluation.

3.6 Disposal of revalued asset

There are two steps to disposing of a revalued asset:

- Calculate gain on disposal by comparing sale proceeds to carrying amount
- Transfer balance on revaluation surplus to retained earnings

Notes

Example 1

Revaluation

An entity revalued its land and buildings at the start of the current year to $10 million ($4 million for the land). The property cost $5 million ($1 million for the land) ten years prior to the revaluation. The total expected useful life of 50 years is unchanged. The entity's policy is to make an annual transfer of realised amounts to retained earnings.

Show the effects of the above on the financial statements for the year.

Through your preparation of this information, this example allows you to demonstrate your problem solving skill.

Statement of profit or loss and other comprehensive income (extract)

	$000
Depreciation (W1)	
Other comprehensive income:	
Revaluation gain (W1)	

Statement of financial position (extract)

Non-current assets	$000
Land and buildings (W1)	
Equity	
Revaluation surplus (SOCIE)	

Statement of changes in equity (extract)

	Revaluation surplus
	$000
Balance b/f	0
Revaluation gain (W1)	
Transfer to retained earnings (W2)	
Balance c/f	

Workings

(W1)

	Land	Buildings	Total
	$000	$000	$000
Cost			
Depreciation			
Carrying amount b/f			
Revaluation gain			
Revalued amount			
Depreciation charge			
Carrying amount c/f			

(W2)

	$000
New depreciation charge	
Old depreciation charge	
Transfer to retained earnings	

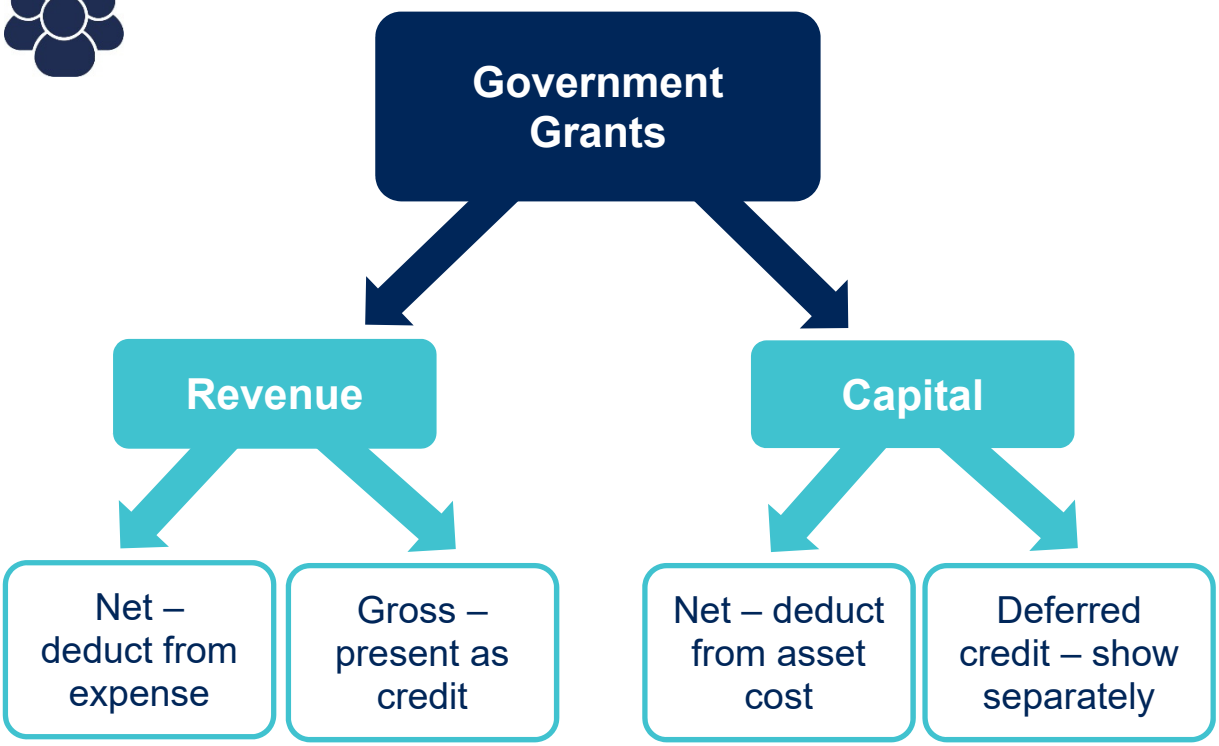
Notes

Illustrations and further practice

Notes

4 IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*

4.1 Types of grant and accounting choices



Notes

Example 2

Revenue grant

An entity receives a government grant of $6 million on 1 January 20X4 to keep staff employed within a deprived area. The company must not make redundancies for the next three years, or the grant is to be repaid in full.

By 31 December 20X4 no redundancies have taken place and none are planned.

How should the grant be treated in the financial statements for the year ended 31 December 20X4?

Notes

Example 3

Capital grant

On 1 April 20X3 an entity receives a government grant of $45,000 towards machinery costing $300,000. It depreciates all plant and machinery at 20% p.a. on a straight-line basis.

Show relevant extracts from the financial statements for the year ended 31 March 20X4 under the net and deferred credit methods in the pro-forma below.

Through your preparation of these extracts, this example allows you to demonstrate your knowledge of standards and principles that apply to IFRS Standards.

	Net	**Deferred credit**
	$000	$000
Statement of profit or loss		
Depreciation		
Grant income		
Statement of financial position		
Property plant & equipment		
Non-current liability: grant		
Current liability: grant		

Illustrations and further practice

Notes

5 IAS 23 *Borrowing costs*

5.1 IAS 23 Treatment

Borrowing costs **must** be capitalised as part of the cost of an asset if that asset is a **qualifying asset** (one which necessarily takes a substantial time to get ready for its intended use or sale).

5.2 Commencement of capitalisation

Capitalisation commences when:

- expenditure for the asset is being incurred, and
- borrowing costs are being incurred, and
- activities that are necessary to prepare the asset for its intended use or sale are in progress.

5.3 Cessation of capitalisation

Capitalisation ceases when:

- substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete, or
- there is an unplanned suspension of construction,

5.4 Interest rate

The rate of interest to be used is:

- actual interest rate where specific funds borrowed, or
- weighted average of general borrowings where general borrowings used.

5.5 Interest income

Where surplus borrowings are invested to earn interest, the interest earned is:

- offset against the cost of the asset if earned during the period of construction
- recognised within profit or loss if earned prior to commencement of construction.

Example 4

Borrowing costs

Grimtown took out a $10 million 6% loan on 1 January 20X1 to build a new football stadium. Not all of the funds were immediately required so $2 million was invested in 3% bonds until 30 June 20X1.

Construction of the stadium began on 1 February 20X1 and was completed on 31 December 20X1.

Calculate the amount of interest to be capitalised in respect of the football stadium as at 31 December 20X1.

	$000
Total interest charge for the year	
Less interest charged to profit or loss	
Interest to be capitalised	

	$000
Total interest earned on investment	
Less interest earned to profit or loss	
Interest to be deducted from asset	

Illustrations and further practice

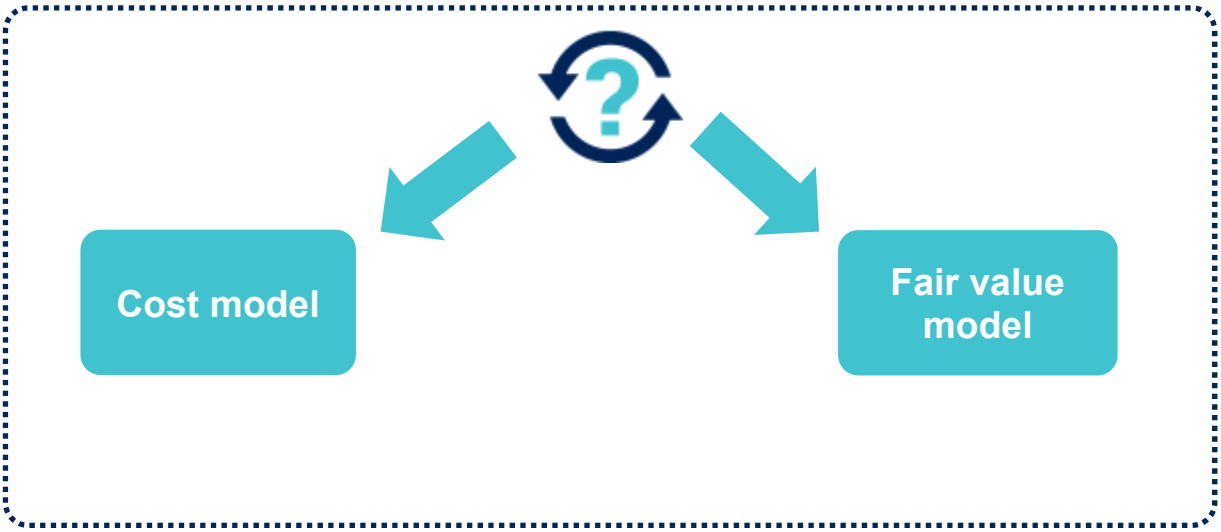
Notes

6 IAS 40 *Investment Property*

6.1 Definition

Investment property is property held for rental income and/or capital appreciation, rather than for use by the entity or for sale in the ordinary course of business.

6.2 IAS 40 Choices



6.3 Cost model

The cost model for investment property is the same as for property held under IAS 16, with depreciation charged as an expense in the statement of profit or loss each year.

6.4 Fair value model

Investment property under the fair value model is accounted for differently to property under the IAS 16 revaluation model:

-
-
-

Example 5

Investment property

Berba purchased a property for $5 million on 1 January 20X7 for its investment potential. The land element of the cost was $1 million, and the buildings element was expected to have a useful life of 50 years. At 31 December 20X7, local property indices suggested that the fair value of the property had risen to $5.5million.

Show extracts from the financial statements of Berba for the year ended 31 December 20X7 in the pro-forma below, using both the cost and fair value models.

Through your preparation of these extracts, this example allows you to demonstrate your knowledge of standards and principles that apply to IFRS Standards.

	Cost	**Fair value**
	$000	$000
Statement of profit or loss		
Depreciation		
Gain on investment property		
Statement of financial position		
Investment property		

Notes

6.5 Transfers to and from investment property

If the **fair value model** for investment property is used, then the property should be revalued before being transferred between investment property and property, plant and equipment.

- From investment property to property, plant and equipment
  –
- From property, plant and equipment to investment property
  –

Illustrations and further practice

Notes

Questions

Notes

Chapter 3

Intangible assets

Outcome

By the end of this session you should be able to:

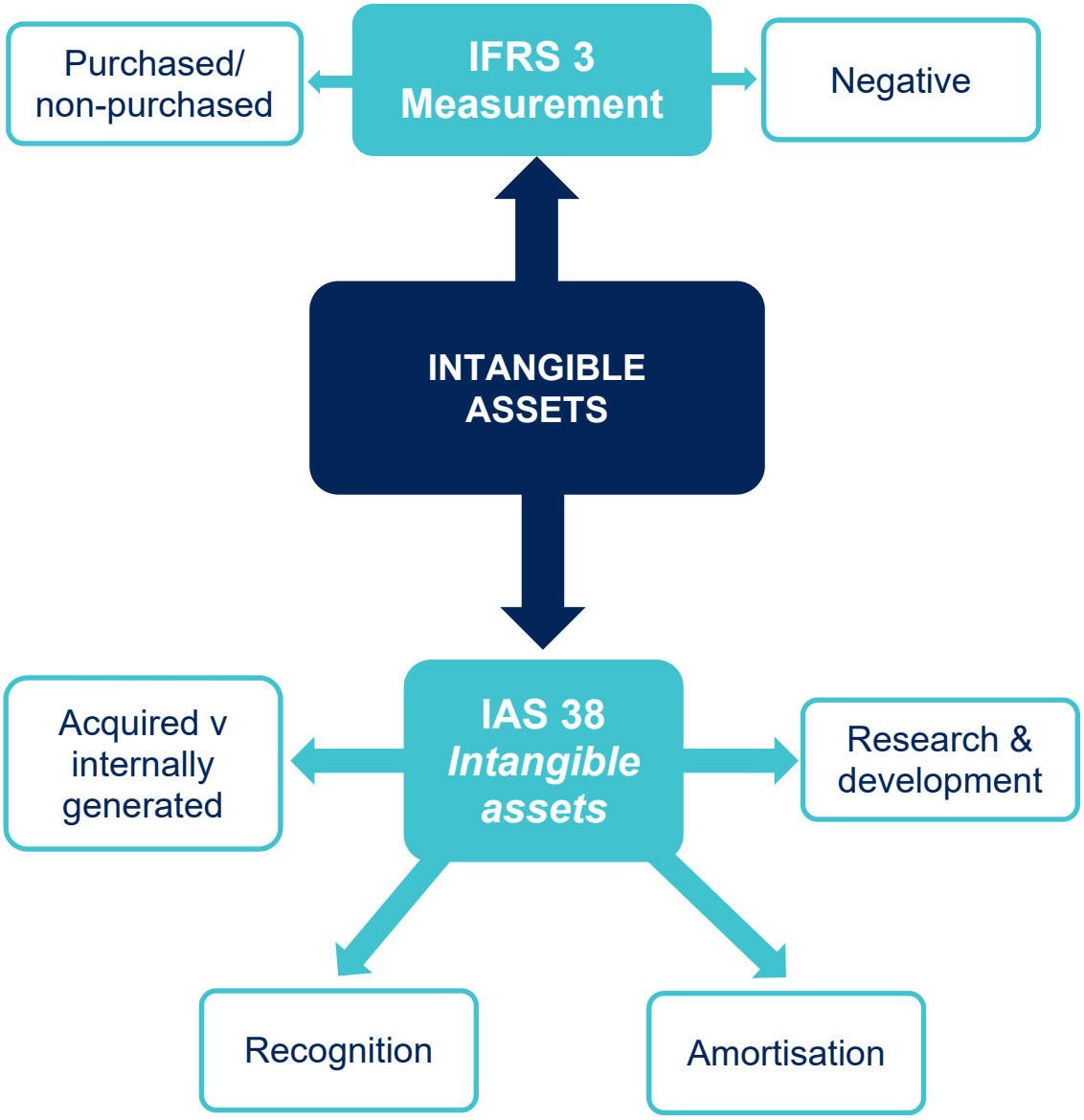
- explain the nature and accounting treatment of internally-generated and purchased intangibles
- describe the criteria for the initial recognition and measurement of intangible assets
- describe and apply the principles of accounting for research and development expenditure

and answer questions relating to these areas.

PER

One of the PER performance objectives (PO6) is to record and process transactions and events. You use the right accounting treatments for transactions and events. These should be both historical and prospective – and include non-routine transactions. Working through this chapter should help you understand how to demonstrate that objective.

Overview


Purchased/ non-purchased
IFRS 3 Measurement
Negative
INTANGIBLE ASSETS
Acquired v internally generated
IAS 38 *Intangible assets*
Research & development
Recognition
Amortisation

1 Recognition and measurement

1.1 Definition

An intangible asset is an **identifiable** non-monetary asset **without physical substance**.

1.2 Identifiable

In order to be identifiable the asset must either

- be **separable** – capable of being separately bought and sold, or
- arise from legal/contractual rights.

1.3 Recognition

An intangible asset must

- meet the above definition
- generate a probable flow of economic benefit
- be capable of reliable measurement.

1.4 Measurement

Purchased intangibles are initially measured at cost. Subsequently there is a choice between:

The revaluation model is rare in practice as its use demands the existence of an active market.

1.5 Amortisation

Intangible assets with a **finite** useful life are **amortised over that life**, usually on a straight-line basis, unless another basis is more appropriate.

Intangible assets with an **indefinite** useful life are not amortised, but are **tested annually for impairment**.

1.6 Internally generated intangible assets

Generally, internally generated intangible assets cannot be capitalised, as the cost of their creation is not capable of reliable measurement.

Notes

2 Goodwill

2.1 Calculation

Goodwill is the difference between the value of a business as a whole and the fair value of its **identifiable** net assets.

2.2 Purchased v non-purchased

Purchased goodwill arises when an entity acquires a business and is discussed in more detail in Chapter 18.

Non-purchased, or inherent, goodwill is not recognised within the financial statements because it is not separable from the business.

2.3 Negative goodwill

Where an acquiring entity pays less for a business than the fair value of its separable net assets, the negative goodwill created is immediately recognised as income in the statement of profit or loss.

Illustrations and further practice

Notes

3 Research and development

3.1 Definitions

Research is original and planned investigation to gain new scientific knowledge or understanding.

Development is the application of knowledge to create some new or improved material, product, service, process or device.

3.2 Accounting treatment

Research expenditure

Development expenditure

3.3 Recognition criteria

P

I

R

A

T

E

Illustrations and further practice

3.4 Amortisation

Amortisation of development expenditure commences as soon as commercial production begins, either on a straight-line basis or in relation to expected production levels.

Notes

Example 1

Amortisation

A company develops a new product at a cost of $400,000. It is anticipated that the product will experience high demand for a period of four years.

Annual production of the product for the next four years, totalling 16 million units, is forecast to be:

	Units (m)
Year 1	3.0
Year 2	4.5
Year 3	6.0
Year 4	2.5

Explain how the development cost could be amortised.

Through your preparation of this explanation, this example allows you to demonstrate your communication skill.

Illustrations and further practice

Notes

Questions

Chapter 4

Impairment of assets

Outcome

By the end of this session you should be able to:

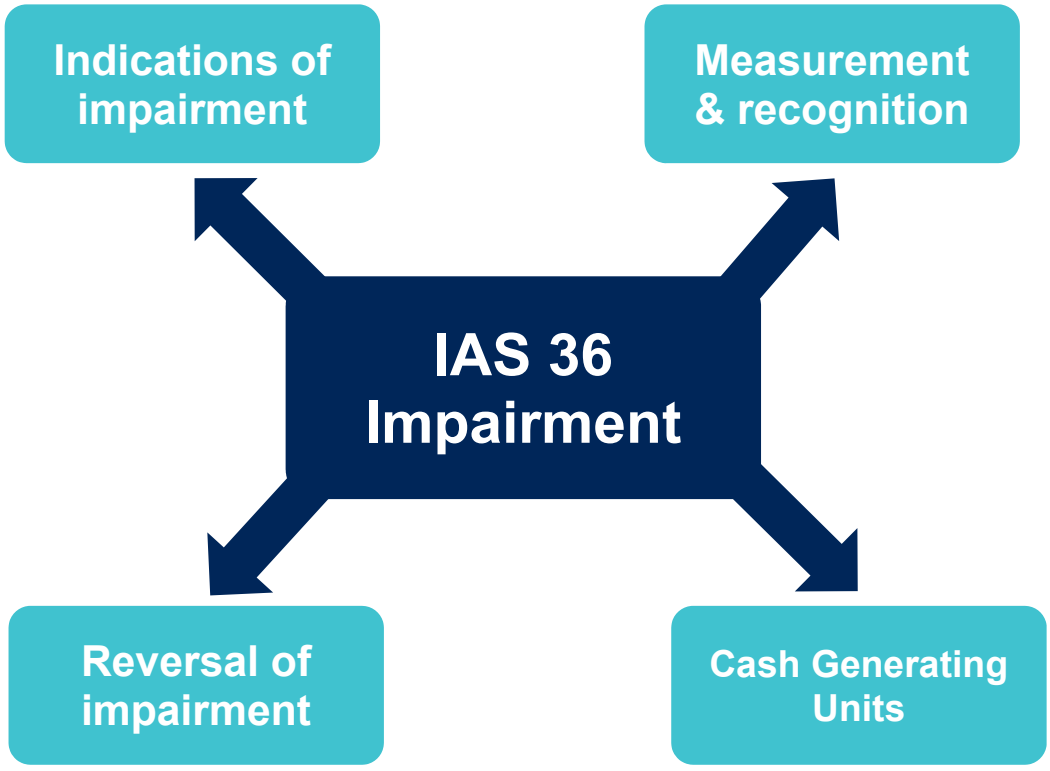
- define, calculate and account for impairment
- identify the circumstances that may indicate impairment
- account for the reversal of an impairment
- describe what is meant by a cash generating unit
- show how impairment should be allocated against the assets of a cash generating unit

and answer questions relating to these areas.

PER

One of the PER performance objectives (PO6) is to record and process transactions and events. You use the right accounting treatments for transactions and events. These should be both historical and prospective – and include non-routine transactions. Working through this chapter should help you understand how to demonstrate that objective.

Overview


Indications of impairment
Measurement & recognition
IAS 36 Impairment
Reversal of impairment
Cash Generating Units

1 Impairment of individual assets

1.1 Definitions

An asset is impaired if its **recoverable amount** is below its **carrying amount**.

An asset's recoverable amount is the higher of its:

- fair value less costs to sell
- value in use: the present value of cash generated by the asset.

1.2 Indications of impairment

Indications of impairment may be either internal or external.

Internal	External

1.3 Recognition and measurement

If impaired, an asset should be written down to its recoverable amount and the impairment loss should be taken to the statement of profit or loss.

The only exception to this is where the asset has previously been revalued, in which case the impairment will first be taken to the revaluation surplus, via other comprehensive income. Any excess would then be taken to the statement of profit or loss.

Notes

Example 1

Impairment

Tintin Co owns a machine that is damaged as a result of a fork-lift truck reversing into it. The machine has a carrying amount of $42,000 at the date of the accident. The damaged machine could be sold for $15,000, but if the company continues to use the asset it will generate cash flows with a present value of $19,000.

How will this be reflected within the financial statements?

Notes

Example 2

Recoverable amount

Sato Co owns a car that was involved in an accident at the year end. It is barely useable, so the value in use is estimated at $1,000. However, the car is a classic and there is a demand for the parts. This results in a fair value less costs to sell of $3,000. The opening carrying amount was $8,000 and the car was estimated to have a life of eight years from the start of the year.

Identify the recoverable amount of the car and any impairment required.

Illustrations and further practice

2 Reversal of impairment

2.1 Changes in recoverable amount

Sometimes the events anticipated to cause impairment of an asset turn out better than predicted. If this happens the recoverable amount is recalculated and the previous impairment reversed.

Example 3

Impairment reversal

On 1 January 20X3 Mono Co purchased a machine at a cost of $24,000. The machine is to be depreciated on a straight-line basis over its estimated useful life of eight years with nil residual value.

At 31 December 20X4 the machine is impaired by $4,500 with no change in its estimated useful life or residual value.

At 31 December 20X6 the conditions which caused the impairment have reversed and the recoverable amount of the machine is $16,000.

How will this be reflected within the financial statements?

Through your preparation your answer, this example allows you to demonstrate your knowledge of standards and principles that apply to IFRS Standards.

Notes

Illustrations and further practice

Notes

3 Cash Generating Units (CGUs)

3.1 Definition

A **Cash Generating Unit** is the smallest identifiable group of assets for which independent cashflows are identifiable.

For example, within a college, independent cashflows are not identifiable for each piece of furniture, or maybe even all the furniture within each classroom, and it is necessary to combine all the assets at a particular location to identify the independent cashflows.

3.2 Impairment calculation

The assets in the CGU are grouped together and their combined value is compared to the total recoverable amount. Impairment exists where the total carrying amount is greater than the total recoverable amount.

3.3 Allocation of impairment

The calculated total impairment needs to be allocated against specific assets.

Notes

Example 4

CGU

Motu Co operates a unit comprising the following assets and carrying amounts at 30 April 20X7.

	$000
Machinery	500
Goodwill	180
Land and buildings	900
Brand	300
Other net assets	120
	2,000

On 30 April 20X7, following a period of adverse publicity, Motu Co decided to scrap the brand. An impairment review established that the recoverable amount of the unit at 30 April 20X7 was $1,170,000. The other net assets are stated at their recoverable amount.

How will this impairment be allocated against the various assets?

Through your preparation of this information, this example allows you to demonstrate your problem solving skill.

Illustrations and further practice

Notes

Questions

Chapter 5

Non-current assets held for sale and discontinued operations

Outcome

By the end of this session you should be able to:

- discuss the importance of identifying non-current assets held for sale and discontinued operations
- define and account for non-current assets held for sale and discontinued operations

and answer questions relating to these areas.

PER

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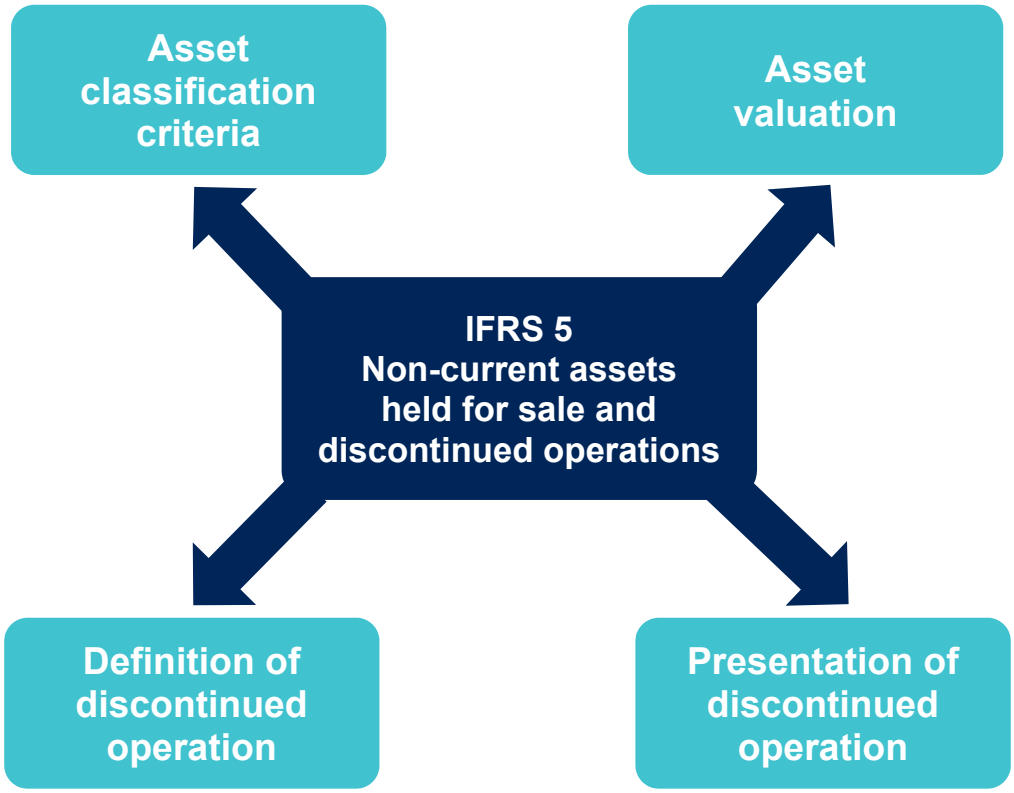
Overview

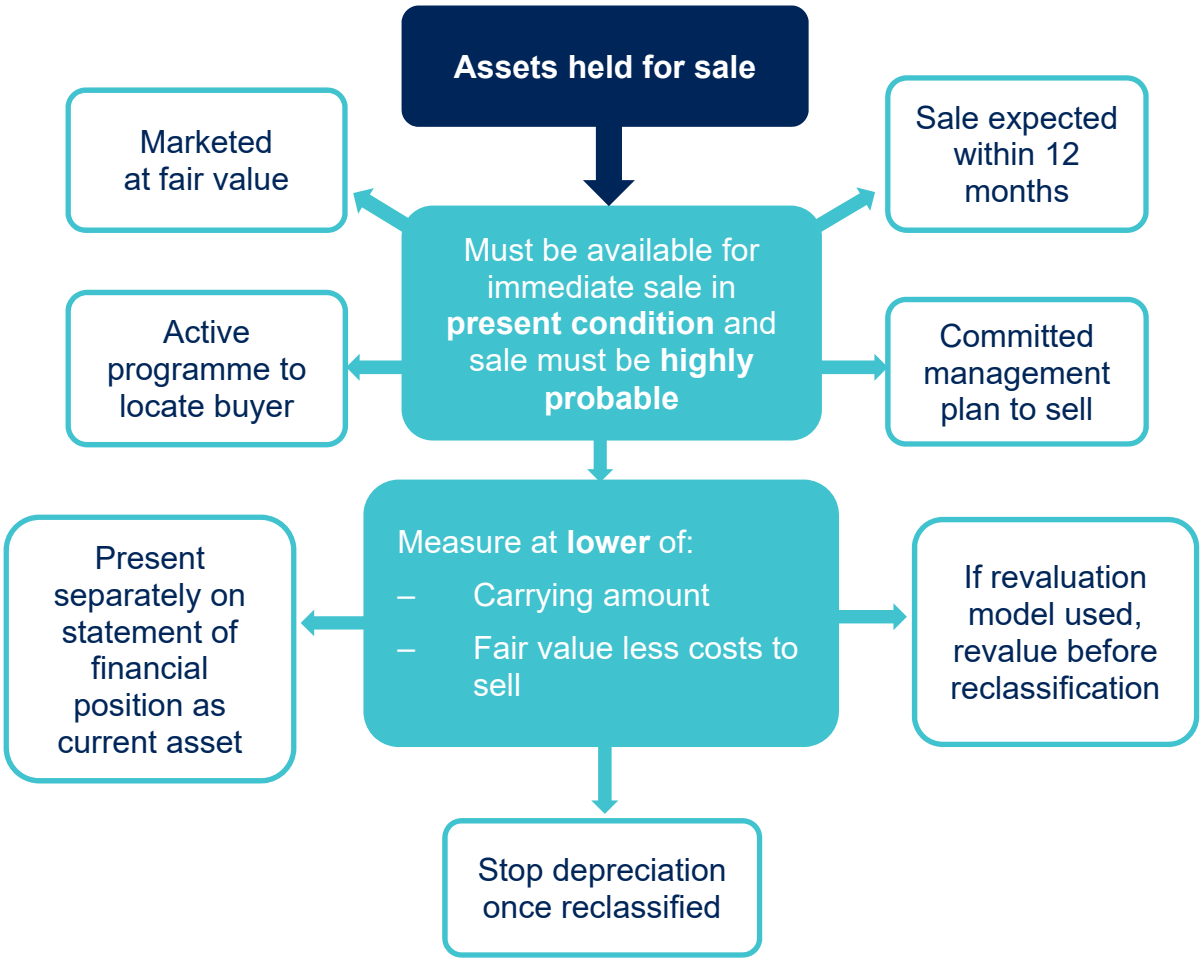

Asset classification criteria
Asset valuation
IFRS 5
Non-current assets held for sale and discontinued operations
Definition of discontinued operation
Presentation of discontinued operation

1 Assets held for sale

1.1 Definition

An **asset held for sale** is one where the carrying amount of the asset will be recovered primarily from a sales transaction rather than continuing use.

1.2 Summary of recognition and measurement


Assets held for sale
Marketed at fair value
Sale expected within 12 months
Must be available for immediate sale in present condition and sale must be highly probable
Active programme to locate buyer
Committed management plan to sell
Measure at lower of:
– Carrying amount
– Fair value less costs to sell
Present separately on statement of financial position as current asset
If revaluation model used, revalue before reclassification
Stop depreciation once reclassified

Illustrations and further practice

Notes

Example 1

Asset held for sale

On 1 January 20X4 Yohan purchased a machine for $60,000. The machine is depreciated on a straight line basis over 4 years, with nil residual value.

On 31 October 20X5, following a decline in demand for its products, Yohan decides to sell the machine and advertises it for sale at its fair value of $33,000. A commission of 5% will be payable on the sale.

At 31 December 20X5, Yohan's financial year-end, the machine remains unsold.

Show the impact of the above on Yohan's financial statements for the year ended 31 December 20X5.

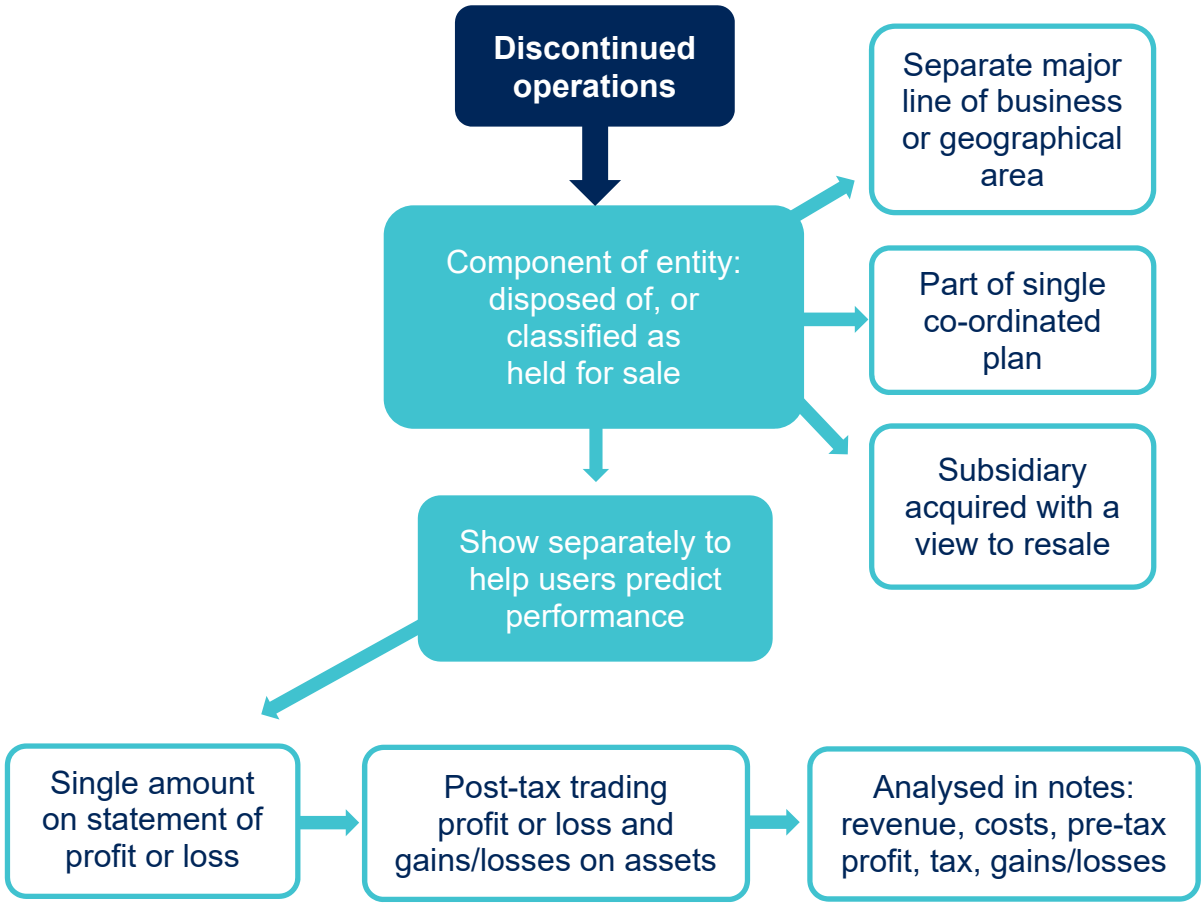
Notes

Illustrations and further practice

Notes

2 Discontinued operations

2.1 Summary of accounting treatment


Discontinued operations
Component of entity: disposed of, or classified as held for sale
Separate major line of business or geographical area
Part of single co-ordinated plan
Subsidiary acquired with a view to resale
Show separately to help users predict performance
Single amount on statement of profit or loss
Post-tax trading profit or loss and gains/losses on assets
Analysed in notes: revenue, costs, pre-tax profit, tax, gains/losses

Notes

2.2 Pro-forma statement of profit or loss

	$
Continuing operations:	
Revenue	X
Cost of sales	(X)
Gross profit	X
Operating costs	(X)
Profit from operations	X
Finance costs	(X)
Profit before tax	X
Income tax expense	(X)
Profit for the period from continuing operations	X
Discontinued operations:	
Profit for the period from discontinued operations	X
Total profit for the period	X

Notes

Example 2

Discontinued operation

On 30 June 20X2 Star closed its polishing division. It sold all the assets, making a loss of $230,000, and made all the staff redundant at a cost of $700,000. During the year to 30 June 20X2 Star made a profit after tax of $350,000 after charging the above expenses. This also included the results of the polishing division, which had made a trading profit of $10,000.

Show how the above results would appear in Star's statement of profit or loss for the year ended 30 June 20X2.

Through your preparation of these extracts, this example allows you to demonstrate your knowledge of financial information.

Illustrations and further practice

Notes

Questions

Notes

Chapter 6

A conceptual and regulatory framework

Outcome

By the end of this session you should be able to:

- explain why a regulatory framework is needed
- describe the International Accounting Standards Board's (the Board's) standard setting process
- explain the relationship between national standard setters and the Board
- describe the objective, scope and core content of IFRS S1
- describe a conceptual framework, distinguishing between a principles-based and a rules-based framework
- define and discuss fundamental and enhancing qualitative characteristics
- define, explain and apply recognition in financial statements of assets, liabilities, income and expenses

and answer questions relating to these areas.

PER

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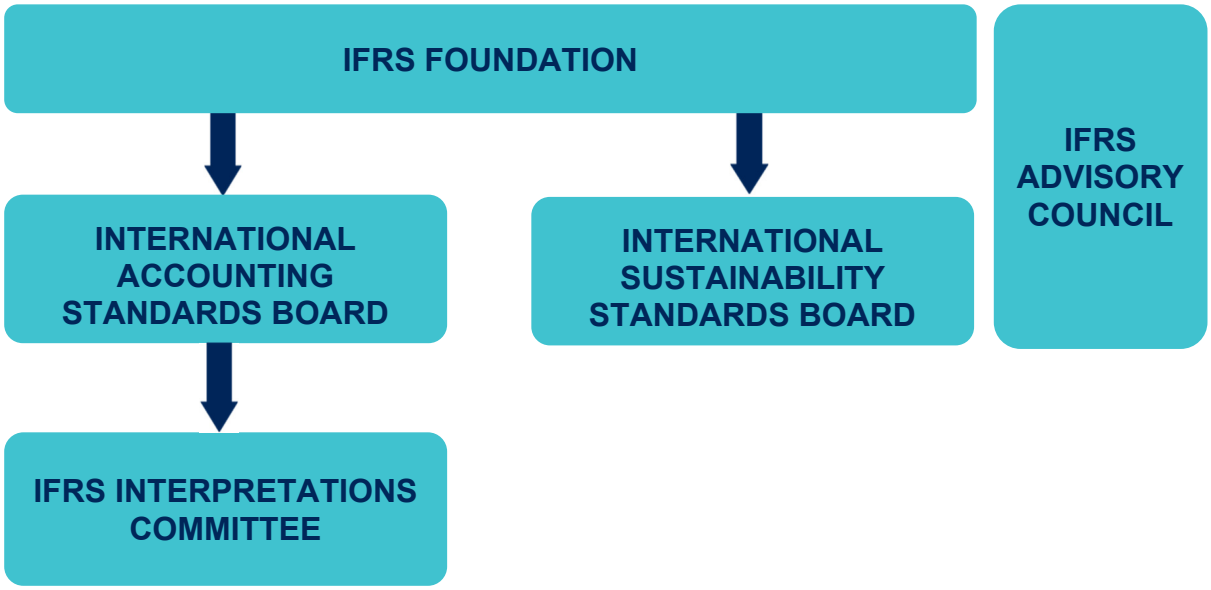
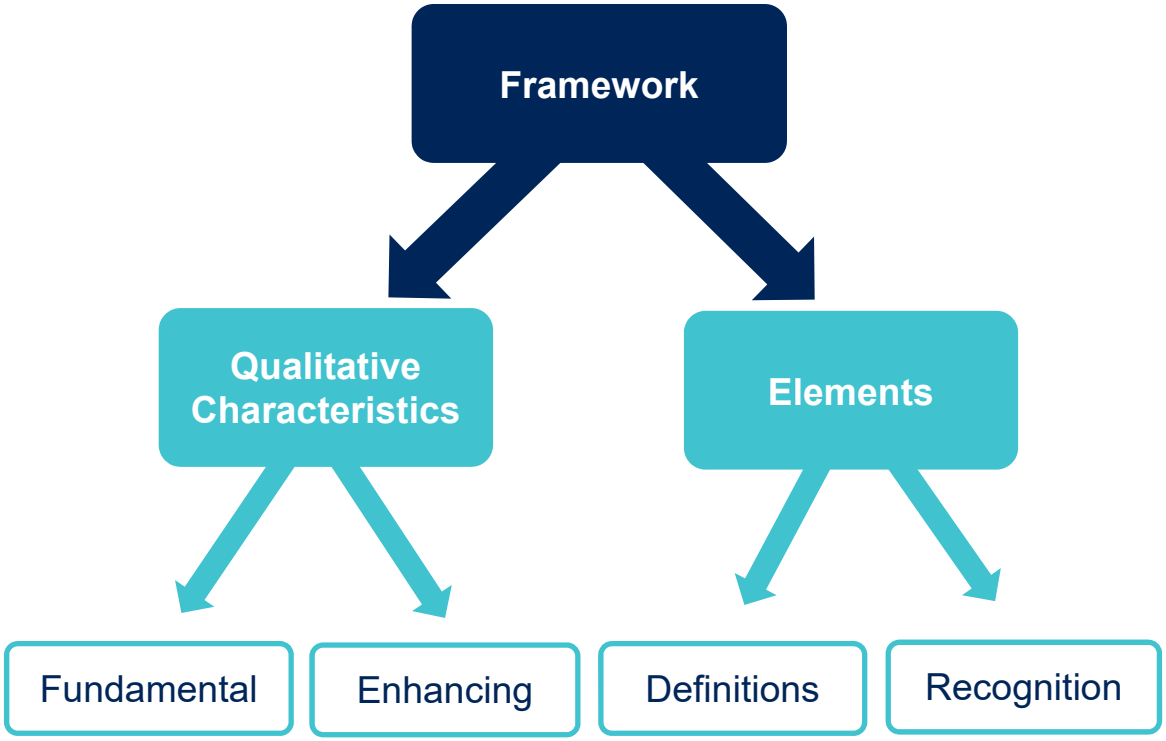
Overview

Regulatory Framework



Conceptual Framework



1 Regulatory Framework

1.1 The standard setting process

- **International Financial Reporting Standards Foundation (the Foundation)**:

- **International Financial Reporting Standards Board (the Board)**:

- **IFRS® Interpretations Committee (IFRIC®)**:

- **IFRS Advisory Council**:

- **International Sustainability Standards Board (ISSB)**:

1.2 Why a framework is needed

- to ensure the achievement of relevant and reliable financial reporting in order to meet the needs of users.

- full regulation of financial statement preparation cannot be achieved by accounting standards alone. Additional control is required in the form of legal and market regulations.

1.3 Principles-based v rules-based accounting

Principles-based accounting

- follows a conceptual framework, such as the Board's Framework

- accounting standards are created based on the conceptual framework.

Rules-based accounting

- accounting standards are a set of rules to be followed

- often described as a 'cookbook' approach.

1.4 Standard setting process

- the Board identifies a subject requiring a new standard
- the Board establishes an Advisory Committee to recommend appropriate treatment
- an Exposure Draft is issued for public comment
- having considered comments received, the Board publishes the standard.

1.5 IFRS Sustainability Disclosure Standard 1 (IFRS S1)

- **Objective**
  - to require an entity to disclose information about its sustainability-related risks and opportunities, useful to decision-making for primary users.
- **Scope**
  - disclosure of '**information about all sustainability-related risks and opportunities that could reasonably be expected to affect the entity's cash flows, its access to finance or cost of capital**'. (IFRS S1: para 3)
- **Core content**
  - Per IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information*, an entity should provide disclosures that cover four sustainability-related areas:
    - **Governance**: governance processes used to monitor sustainability-related risks and opportunities.
    - **Strategy**: approach that the entity uses to manage sustainability-related risks and opportunities.
    - **Risk management**: processes that the entity uses to identify, assess, prioritise and monitor sustainability-related risks and opportunities.
    - **Metrics**: the entity's performance in relation to sustainability-related risks and opportunities, including progress towards any targets the entity has set or is required to meet by law or regulation.

1.6 National standard setters

- committed to a framework of standards based on IFRS Standards
- trend towards harmonisation means that national standards which conflict with IFRS Standards are unlikely to be produced.

Illustrations and further practice

Notes

2 Conceptual Framework

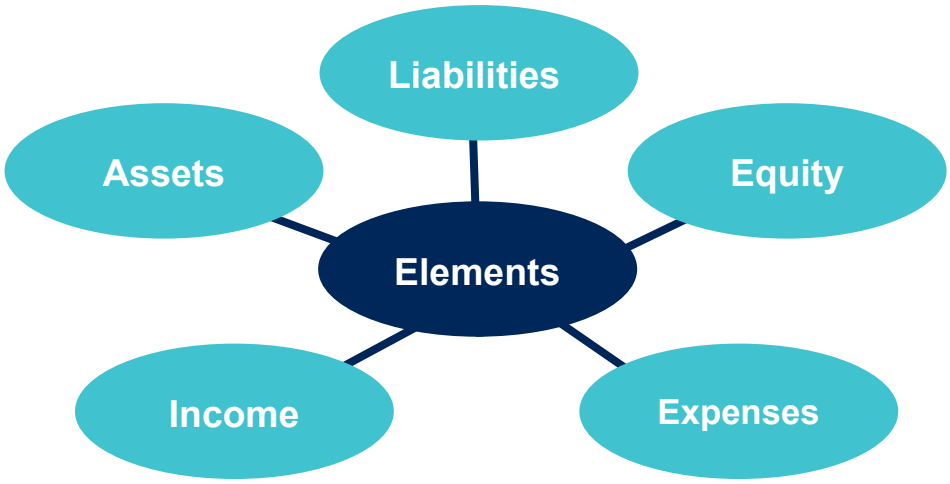
2.1 Qualitative characteristics

Qualitative characteristics are attributes that make information useful. The Framework splits the characteristics between:

- **Fundamental**
  - Relevance
    -
    -
  - Faithful representation
    -
    -
    -
- **Enhancing**
  - Comparability
  - Verifiability
  - Timeliness
  - Understandability.

Notes

2.2 Elements



Notes

2.3 Definitions

- **Asset**

- **Liability**

- **Equity**

- **Income** (Framework, para 4.68)

- **Expenses** (Framework, para 4.69)

You need to learn these definitions.

Notes

2.4 Recognition

An item that meets the definition of an element will be recognised if its recognition provides:

- relevant information
- faithful representation of the element.

These may not be provided where there are high levels of uncertainty or low probabilities of inflow or outflow of economic resources.

Illustrations and further practice

Notes

Notes

Chapter 7

Conceptual framework: measurement

Outcome

By the end of this session you should be able to:

- explain the use of:
  - historical cost
  - current cost
  - value in use
  - fair value
- discuss advantages and disadvantages of historical cost accounting
- discuss whether the use of current value accounting overcomes the problems of historical cost accounting

  and answer questions relating to these areas.

PER

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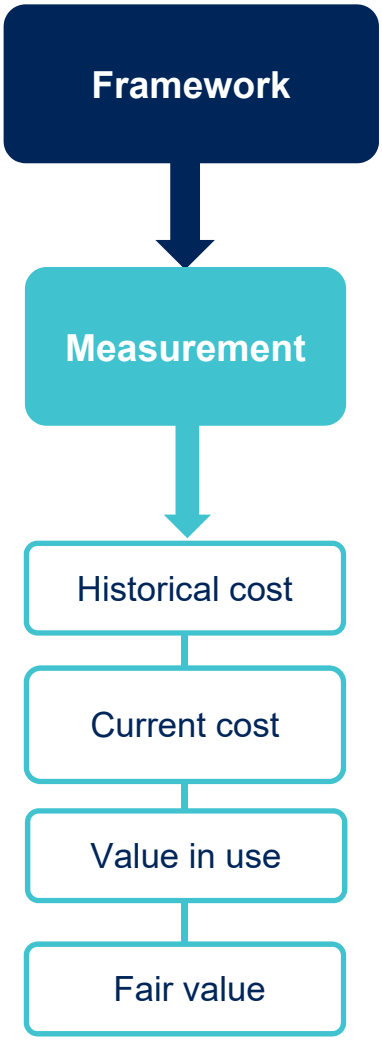
Overview


Framework
Measurement
Historical cost
Current cost
Value in use
Fair value

1 Measurement

1.1 Measurement bases

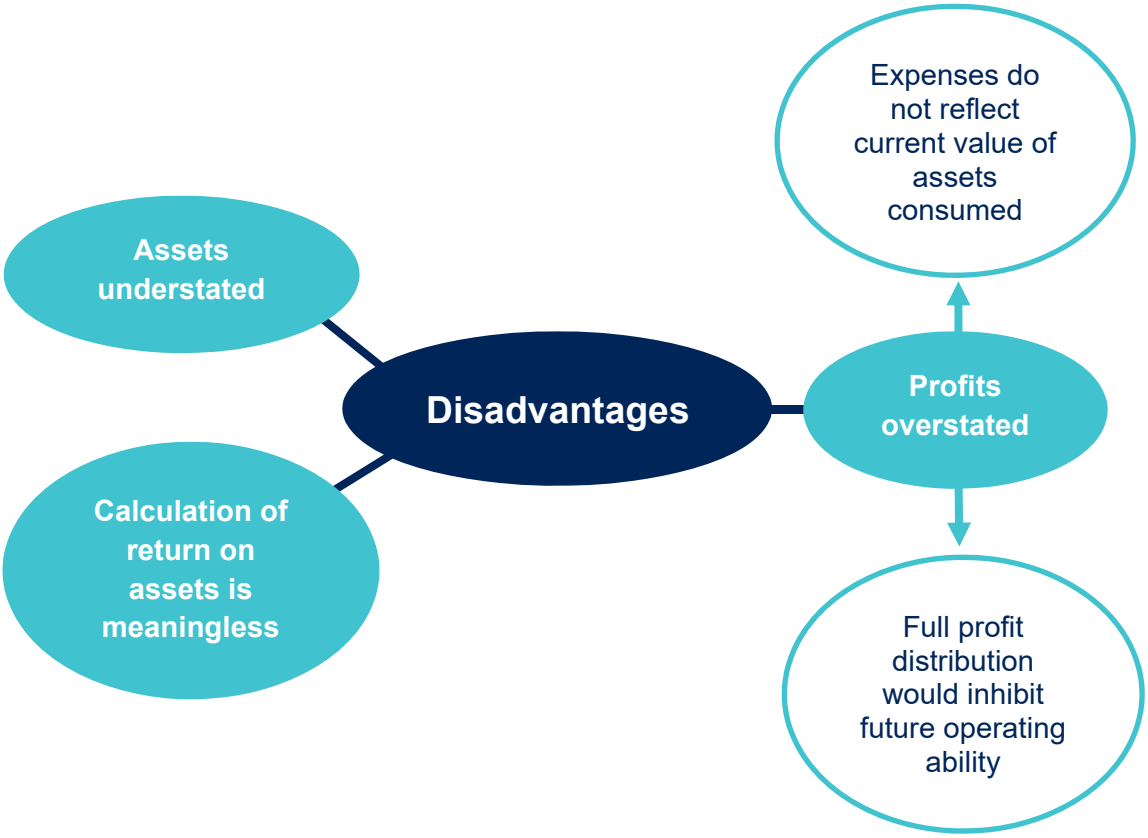
The IASB® Conceptual Framework (the Framework) lists the following measurement bases:

- **Historical cost**
- **Current cost**
- **Value in use**
- **Fair value**

1.2 Advantages of financial statements produced using historical cost

Notes

1.3 Disadvantages of financial statements produced using historical cost


Expenses do not reflect current value of assets consumed
Assets understated
Disadvantages
Profits overstated
Calculation of return on assets is meaningless
Full profit distribution would inhibit future operating ability

Notes

1.4 Alternatives to historical cost accounting

There are two main forms of current value accounting which seek to tackle the disadvantages of historical cost accounting.

- **Constant Purchasing Power (CPP)**

Figures in the financial statements are adjusted to reflect amounts with the same purchasing power, using a general price index.

- **Current Cost Accounting (CCA)**

All costs in the statement of profit or loss are adjusted to show the value of assets consumed during the period, based on current rather than historical values.

Illustrations and further practice

Notes

Chapter 8

Other standards

Outcome

By the end of this session you should be able to:

- account for changes in accounting estimates, changes in accounting policy and correction of prior period errors
- explain and compute amounts using fair value
- describe and apply the principles of inventory valuation
- describe and apply the principles of accounting for biological assets

and answer questions relating to these areas.

PER

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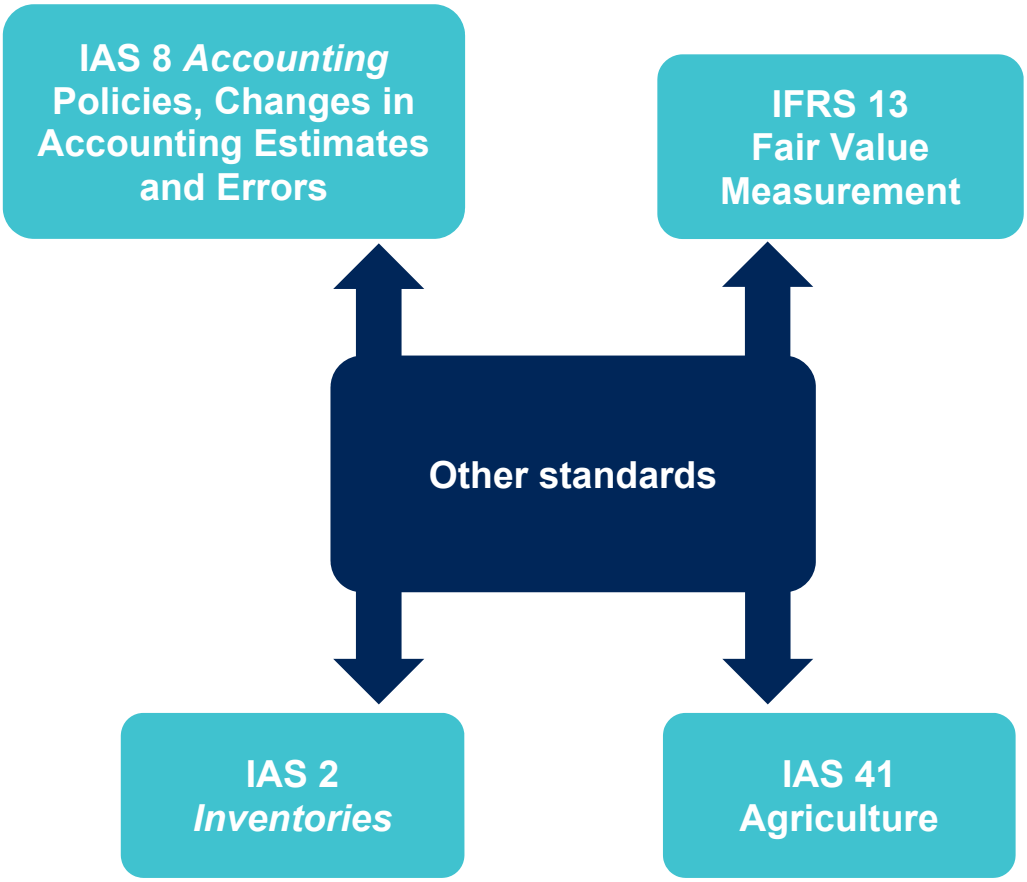

IAS 8 *Accounting* Policies, Changes in Accounting Estimates and Errors
IFRS 13 Fair Value Measurement
Other standards
IAS 2 *Inventories*
IAS 41 Agriculture

1 IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

1.1 Definition of accounting policies

'Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements' (IAS 8, para 5).

1.2 Selection of accounting policies

IAS 8 requires an entity to select and apply appropriate accounting policies to ensure that the information in financial statements

- is relevant to the decision-making needs of users, and
- faithfully represents the entity's performance and position.

1.3 Changes in accounting policy

- applied retrospectively, as if new policy had always been in place
- restate comparatives
- restate relevant brought forward balances.

1.4 Changes in accounting estimate

- applied prospectively, from current period onwards
- disclose, if impact is material

1.5 Errors

- applied retrospectively, amending error
- restate affected comparatives
- restate relevant brought forward balances.

Illustrations and further practice

Notes

2 IFRS 13 *Fair Value Measurement*

2.1 Definition

Fair value is '**the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants'** (IFRS 13, para 9).

2.2 Hierarchy of inputs

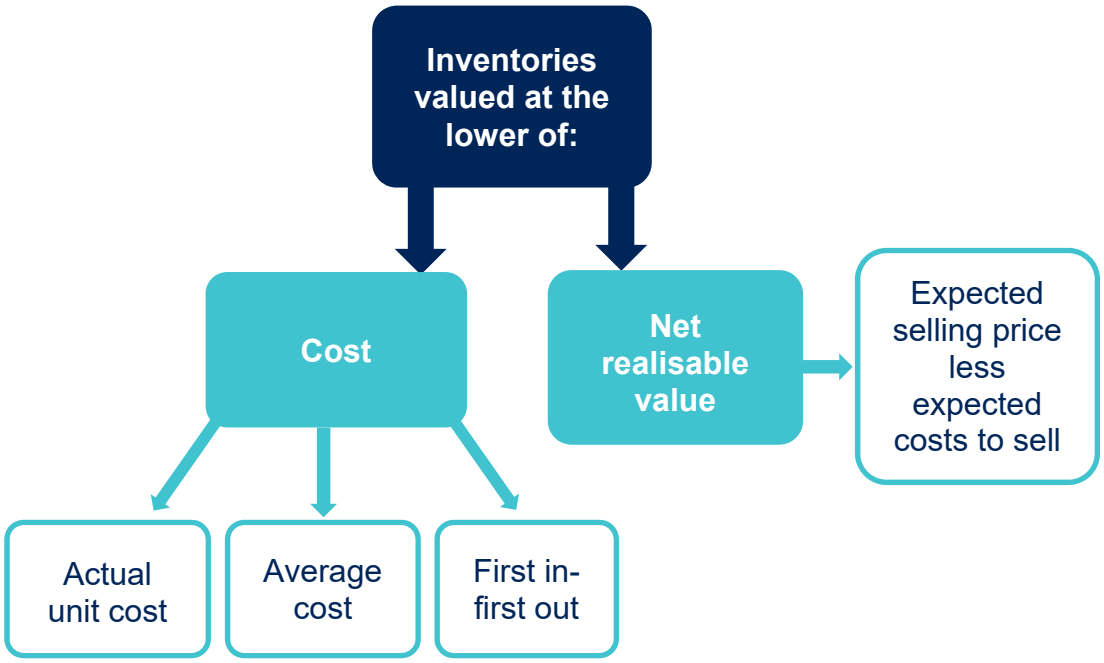
- **Level 1**:
- **Level 2**:
- **Level 3**:

You need to learn the hierarchy of inputs.

Notes

3 IAS 2 *Inventories*

3.1 Summary of valuation



3.2 Definition of cost

Cost is the cost of bringing items to their present location and condition.

Notes

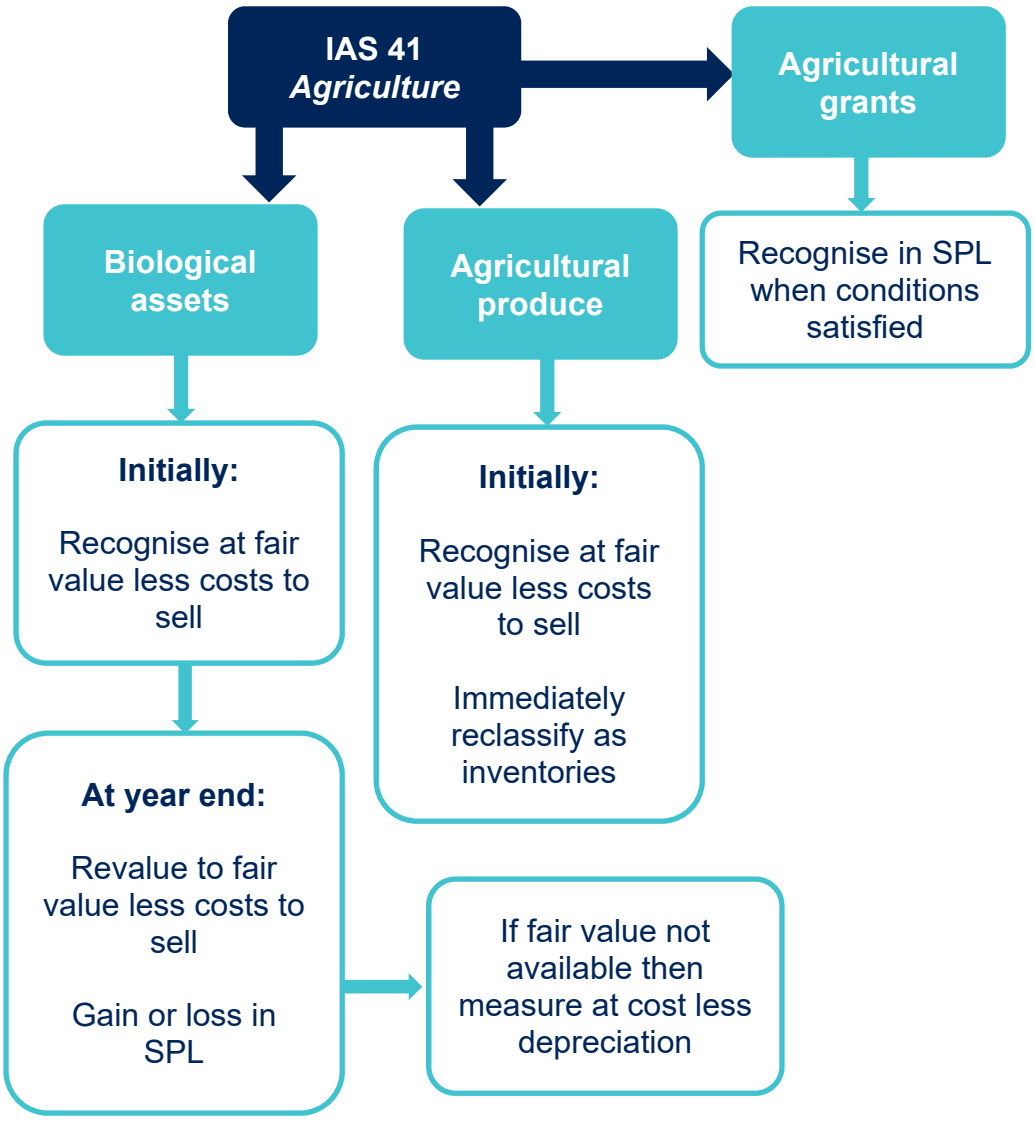
4 IAS 41 *Agriculture*

4.1 Definitions

A **biological asset** is a living plant or animal.

Agricultural produce is the produce harvested from a biological asset.

4.2 Summary of recognition and measurement


IAS 41 *Agriculture*
Agricultural grants
Recognise in SPL when conditions satisfied
Biological assets
Agricultural produce
Initially:
Recognise at fair value less costs to sell
At year end:
Revalue to fair value less costs to sell
Gain or loss in SPL
If fair value not available then measure at cost less depreciation
Initially:
Recognise at fair value less costs to sell
Immediately reclassify as inventories

Questions

Chapter 9

Foreign currency

Outcome

By the end of this session you should be able to:

- define presentation and functional currencies
- record transactions in a foreign currency

and answer questions relating to these areas.

PER

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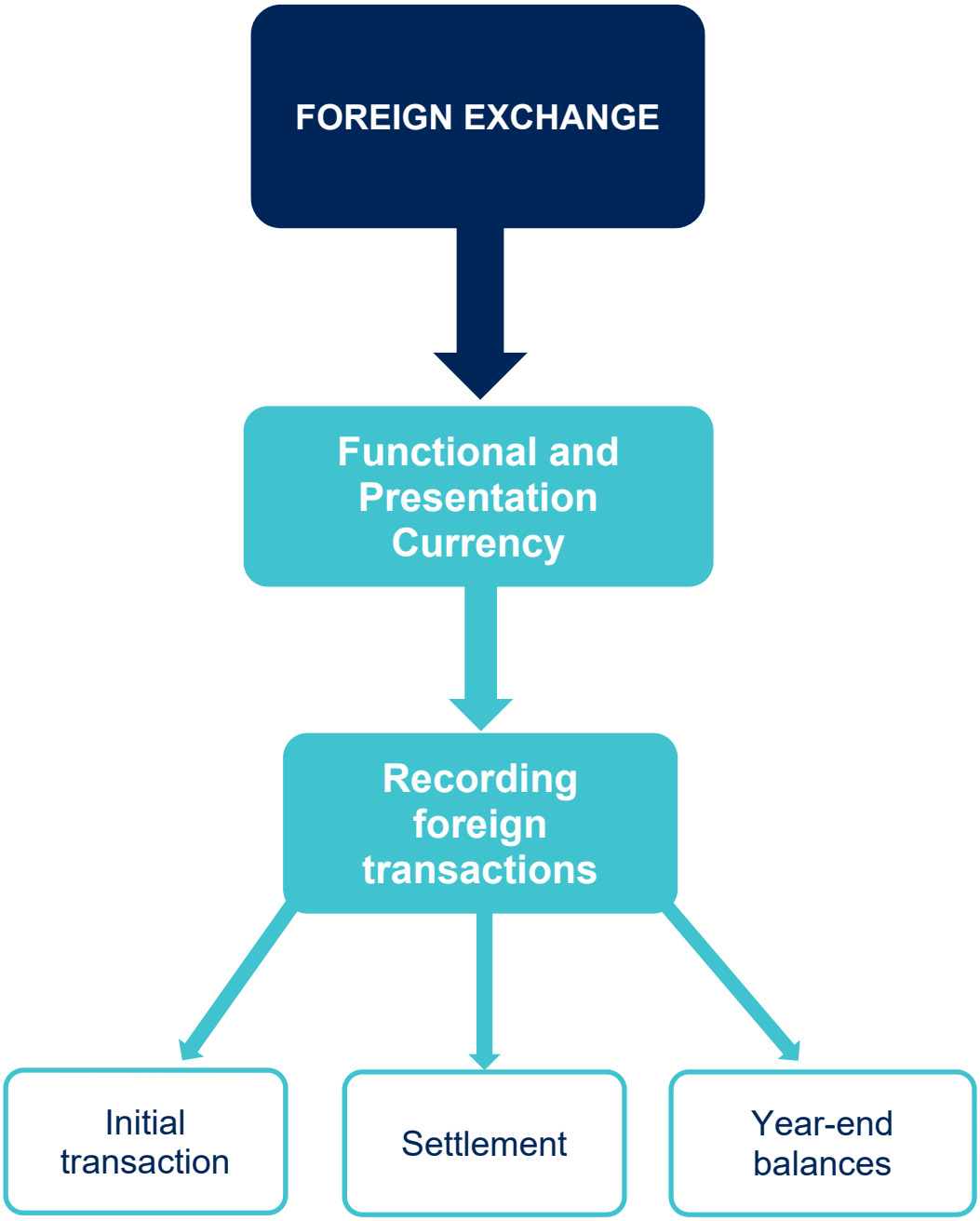

FOREIGN EXCHANGE
Functional and Presentation Currency
Recording foreign transactions
Initial transaction
Settlement
Year-end balances

1 Currency

1.1 Definitions

Functional Currency

'the currency of the primary economic environment in which an entity operates' (IAS 21, para 8).

Presentation Currency

'the currency in which the financial statements are presented' (IAS 21, para 8).

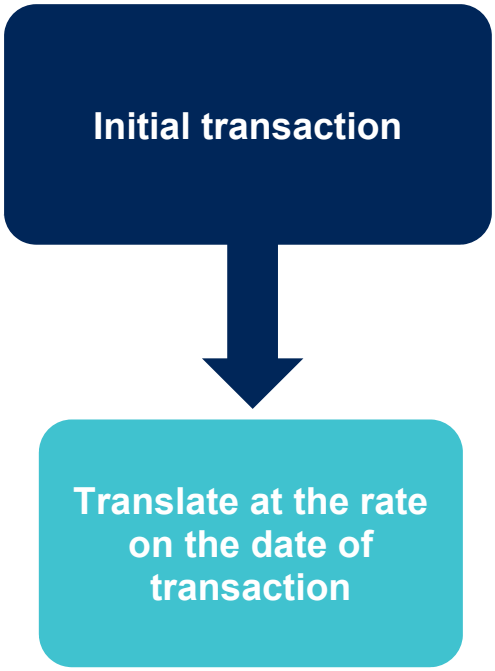
1.2 Factors influencing functional currency

Notes

2 Translating transactions

2.1 Initial transactions and settlements

Overseas transactions must be translated into the entity's functional currency before they are recorded.



If exchange rates have moved between the initial transaction and the settlement date then a foreign exchange gain or loss will arise. This is recorded in the statement of profit or loss.

Notes

Example 1

Settled transactions

On 1 April 20X8 Collins Co, a company that uses the dollar ($) as its functional currency, buys goods from an overseas supplier, who uses Kromits (Kr) as its functional currency. The goods are priced at Kr54,000. Payment is made 2 months later on 31 May 20X8.

The prevailing exchange rates are:

1 April 20X8 Kr1.80 : $1

31 May 20X8 Kr1.75 : $1

Required:

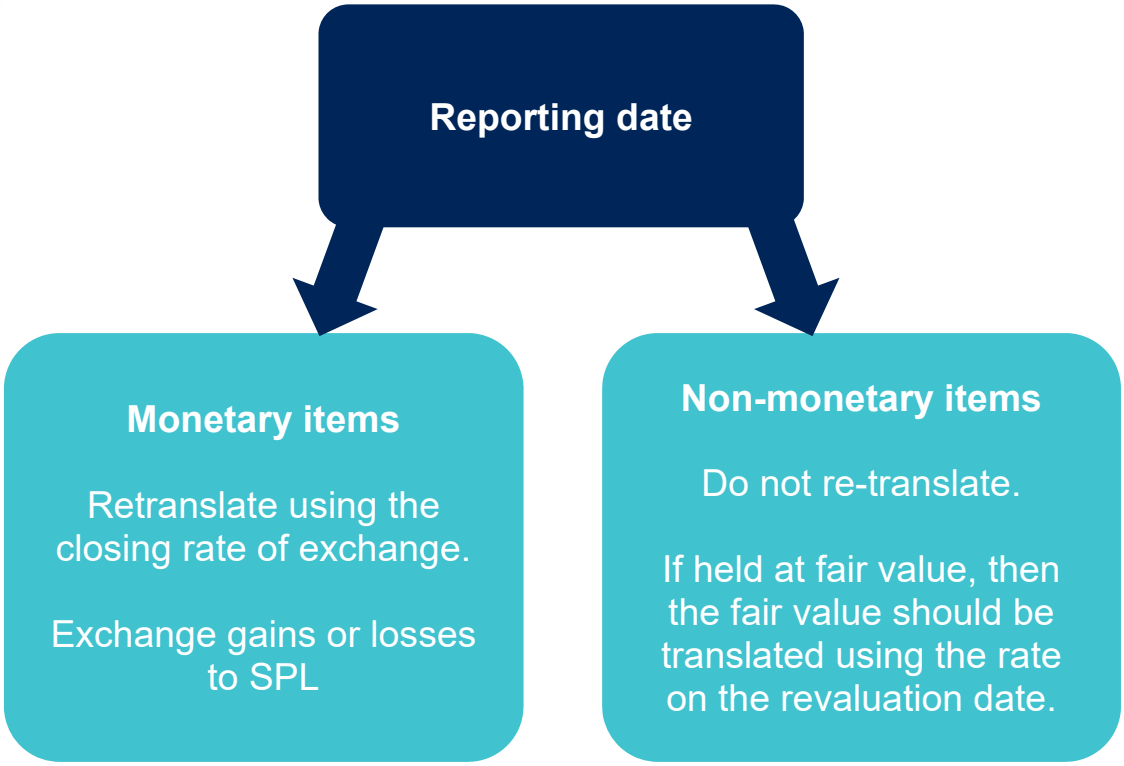
Record the journal entries for these transactions.

Notes

2.2 Unsettled balances at the reporting date

The treatment of a balance at the reporting date depends on whether it is **monetary** or **non-monetary**.

Monetary items are those assets or liabilities that will lead to the receipt or payment of cash. This includes receivables, payables and loans.


Reporting date
Monetary items
Retranslate using the closing rate of exchange.
Exchange gains or losses to SPL
Non-monetary items
Do not re-translate.
If held at fair value, then the fair value should be translated using the rate on the revaluation date.

Notes

Example 2

Unsettled transactions

Vardy has a year end of 31 December and uses the dollar ($) as its functional currency.

On 1 December 20X8 Vardy purchased goods on credit from an overseas supplier, whose functional currency is the Dinar (D). The goods were priced at D60,000 and the supplier allowed Vardy 60 days' credit.

Rates of exchange were as follows:

1 December 20X8 $1 = D1.50

31 December 20X8 $1 = D1.80

Record the journals for this transaction for the year ended 31 December 20X8.

Through your preparation of this journal, this example allows you to demonstrate your knowledge of standards and principles that apply to IFRS Standards.

Notes

Example 3

Non-monetary items at fair value

Morgan has a year end of 31 December and uses the dollar ($) as its functional currency.

On 1 July 20X6 Morgan purchased land in Riponia, whose currency is the Ripp (R). The land cost R600,000.

On 31 December 20X7 Morgan revalued the land to R750,000.

Rates of exchange were as follows:

1 July 20X6	$1 = R2.00
31 December 20X7	$1 = R1.50

Record the journals for these transactions.

Through your preparation of this information, this example allows you to demonstrate your problem solving skill.

Questions

Chapter 10

Revenue

Outcome

By the end of this session you should be able to:

- explain and apply the five-step model of revenue recognition
- explain and apply revenue recognition criteria where performance obligations are satisfied over time or at a point in time
- describe acceptable methods for measuring contract progress

and answer questions relating to these areas.

PER

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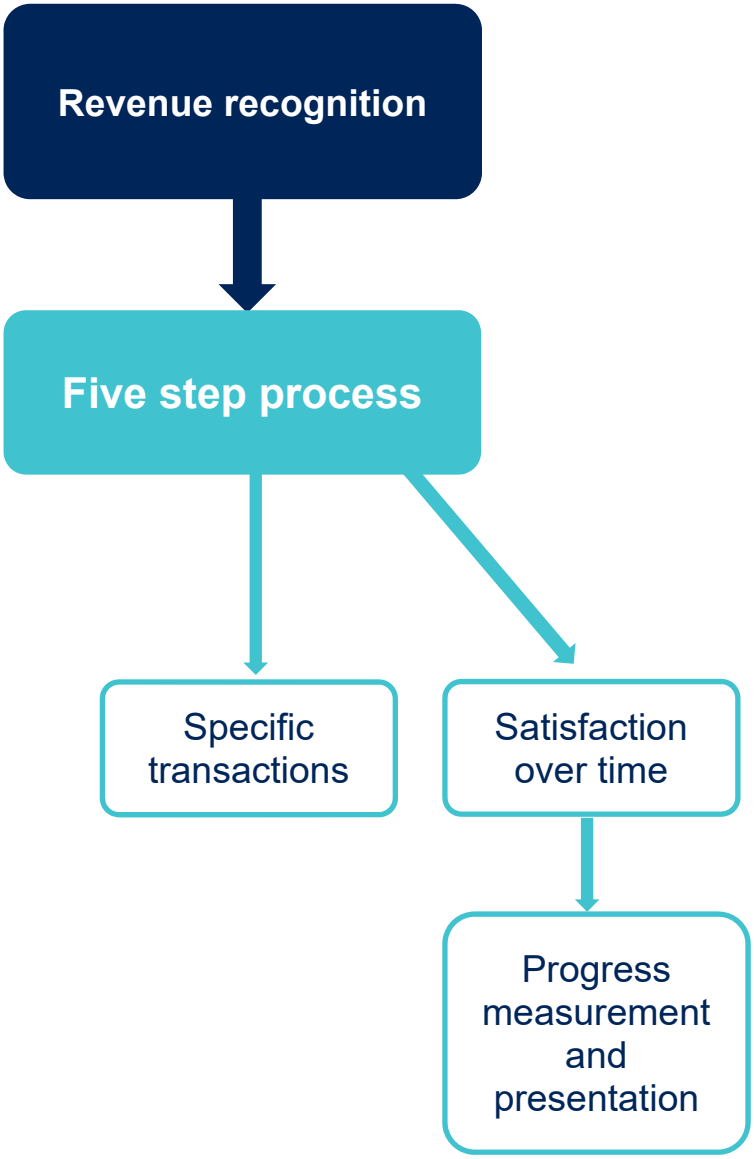
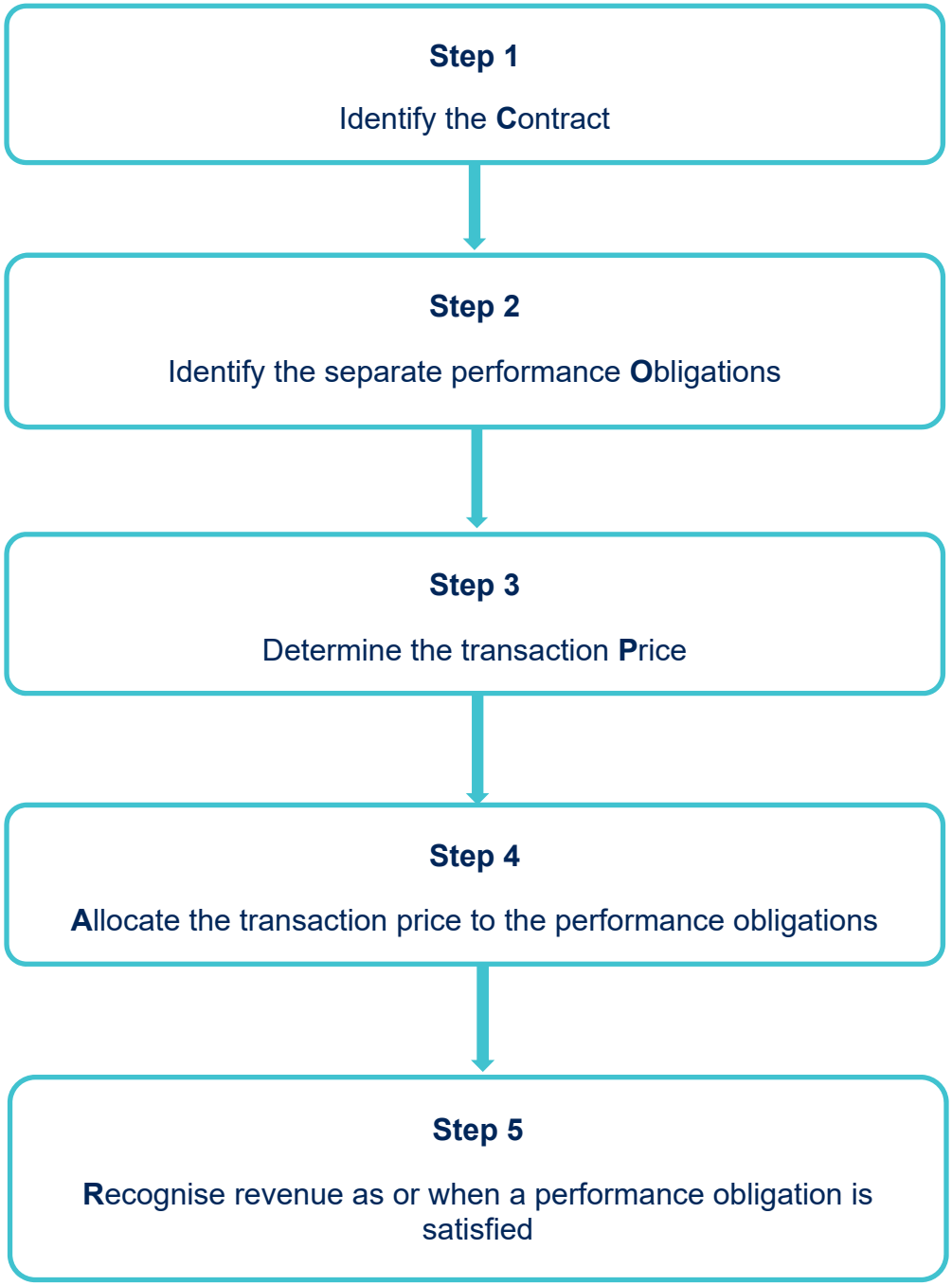
Overview


Revenue recognition
Five step process
Specific transactions
Satisfaction over time
Progress measurement and presentation

1 Revenue recognition

1.1 A five step process – COPAR!


Step 1
Identify the Contract
Step 2
Identify the separate performance Obligations
Step 3
Determine the transaction Price
Step 4
Allocate the transaction price to the performance obligations
Step 5
Recognise revenue as or when a performance obligation is satisfied

1.2 Step 1: Identify the contract

IFRS 15 *Revenue from Contracts with Customers* says that a contract is an agreement between two parties that creates rights and obligations.

Illustration 1

Alma has a year end of 31 December 20X1.

On 30 September 20X1, Alma signed a contract with a customer to provide them with an asset on 31 December 20X1. The customer agreed to pay $1 million on 30 June 20X2.

Control over the asset passed to the customer on 31 December 20X1.

By 31 December 20X1, as a result of changes in the economic climate, Alma did not believe it was probable that it would collect the consideration that it was entitled to.

Therefore, the contract cannot be accounted for and no revenue should be recognised.

Notes

1.3 Step 2: Identify the performance obligations

IFRS 15 says that the distinct performance obligations within a contract must be identified.

Performance obligations are promises to transfer distinct goods or services to a customer. There may be more than one performance obligation within a contract.

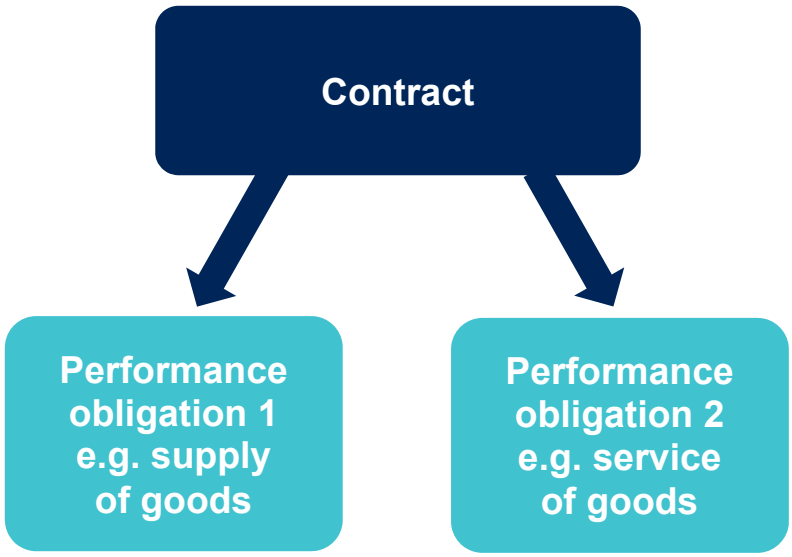


Illustration 2

An entity enters into a contract with a customer to sell a car, which includes one year's 'free' maintenance.

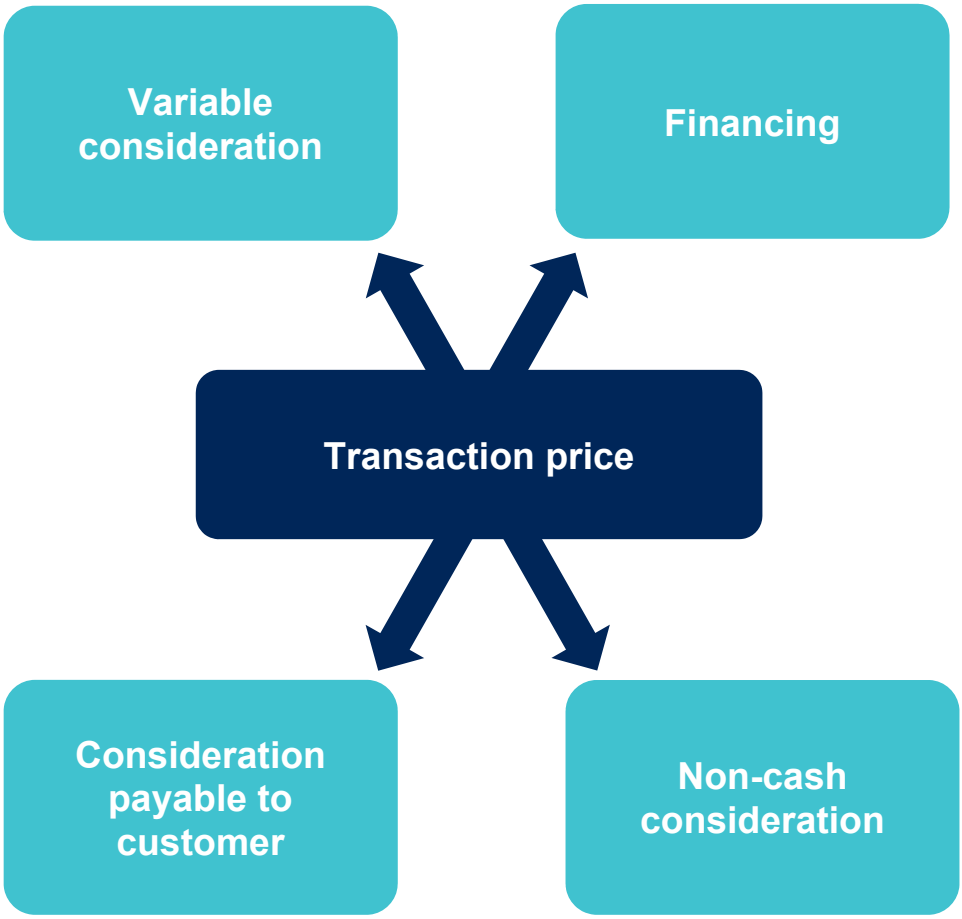
The sale of the car and the provision of maintenance services are separate performance obligations.

Notes

1.4 Step 3: Determine the transaction price

The **transaction price** is the consideration that the selling entity will be entitled to once it has fulfilled the performance obligations in the contract.

There are a number of issues to consider here:



Notes

Variable consideration

IFRS 15 says that if a contract includes variable consideration (e.g. a bonus or a penalty for early or late completion) then the entity must estimate the amount it expects to receive, but only include such value within the transaction price if the likelihood of payment is highly probable.

The method of estimation will depend on the potential outcomes, either the most likely amount if the contract has only two possible outcomes, or an expected value if an entity has a large number of contracts with similar characteristics.

Financing

A significant financing component is deemed to exist when there is a substantial delay between the customer receiving the goods or services and making payment for those goods or services, even if this is advertised as 'interest-free'. In this case the consideration receivable needs to be discounted to present value using the rate at which the customer is able to borrow money.

Non-cash consideration

Any non-cash consideration (e.g. shares) is measured at fair value.

Consideration payable to a customer

If consideration is paid to a customer in exchange for a distinct good or service, then it should be accounted for as a separate purchase transaction.

Assuming that the consideration paid to a customer is not in exchange for a distinct good or service, an entity should account for it as a reduction in the transaction price.

Illustrations and further practice

Notes

Example 1

Financing element

Rudd Co enters into a contract with a customer to sell equipment on 31 December 20X1. Control of the equipment transfers to the customer on that date. The price stated in the contract is $1m and is due on 31 December 20X3.

Market rates of interest available to this particular customer are 10%.

Required:

Explain how this transaction should be accounted for in the financial statements of Rudd Co for the years ended 31 December 20X1, 20X2 and 20X3.

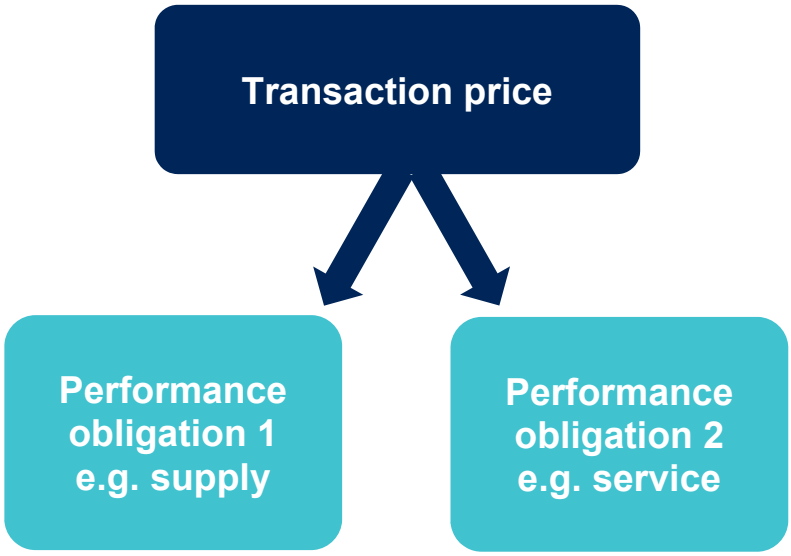
Through your preparation of this explanation, this example allows you to demonstrate your communication skills.

Solution

Notes

1.5 Step 4: Allocate the transaction price

The total transaction price should be allocated to each performance obligation in proportion to stand-alone selling prices.



If a stand-alone selling price is not directly observable then it must be estimated.

Notes

Example 2

Allocation of price

Shred Co sells a machine and one year's 'free' technical support for $120,000. It usually sells the machine for $120,000 but does not sell technical support for this machine as a stand-alone product. Other support services offered by Shred Co attract a mark-up of 50%. It is expected that the technical support will cost Shred Co $20,000.

Required:

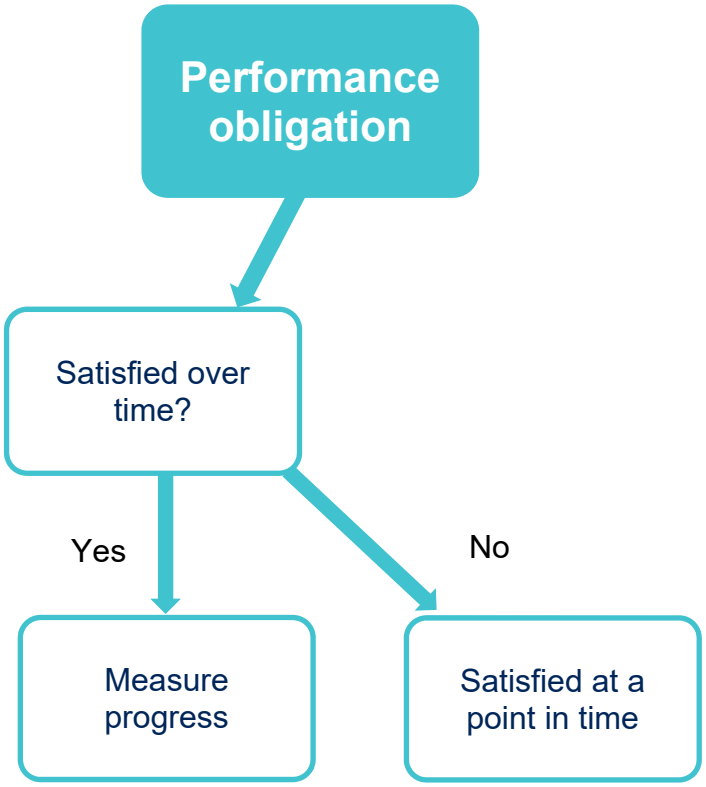
How should the transaction price be allocated between the machine and the technical support?

Notes

1.6 Step 5: Recognise revenue

Revenue is recognised when or as the entity satisfies a performance obligation by transferring a promised good or service to a customer.

An entity must determine at contract inception whether it satisfies the performance obligation over time or at a point in time.



Notes

2 Performance obligation satisfied over time

2.1 Satisfaction criteria

IFRS 15 states that an entity only satisfies a performance obligation over time if **one** of the following criteria is met:

- the customer simultaneously receives and consumes the benefits from the entity's performance
- the entity is creating or enhancing an asset controlled by the customer
- the entity cannot use the asset 'for an alternative use' and the entity can demand payment for its performance to-date.

If a performance obligation is not satisfied over time then it is satisfied at a point in time (see Section 3 below).

If a performance obligation is satisfied over time, then revenue is recognised based on the progress towards completion.

Progress towards completion may be measured using either an **input** method (based on costs incurred as a proportion of total expected cost) or an **output** method (based on value of work completed as a proportion of total contract price).

Notes

Illustration 3

Mendy entered into a contract to construct an office block for a customer. Mendy is entitled to payment for work completed to date. Under IFRS 15 this would mean that Mendy's performance obligation would be satisfied over time. Details at the year-end are as follows:

	$
Contract price	500,000
Costs to date	300,000
Estimated costs to completion	100,000
Value of work certified to date	400,000

The stage of completion may be estimated either using cost values (inputs) or sales values (outputs).

Inputs

Stage of completion is calculated by comparing costs to date to estimated total costs:

Outputs

Stage of completion is calculated by comparing work certified to date to total contract price:

2.2 Contract costs

An asset should be recognised for the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs.

For the purposes of the FR exam, any costs incurred to fulfil a contract with a customer should be expensed to the statement of profit or loss as they are incurred.

2.3 Assets and liabilities

If the entity recognises revenue before it has received consideration then it should recognise either:

- **a receivable** if the right to consideration is unconditional, or
- **a contract asset**.

A **contract liability** is recognised if the entity receives consideration before the related revenue has been recognised.

2.4 Calculation of the contract asset or liability

The contract asset/liability is calculated as follows:

	$
Revenue recognised to date	X
Less: invoiced to customer	(X)
Contract asset/(liability)	X/(X)

2.5 Loss-making contracts

Where it is estimated that a contract will produce a loss rather than a profit, the loss is recognised in full immediately by increasing cost of sales. The simplest way to calculate the cost of sales figure is to add the estimated loss to the revenue figure (calculated based on progress).

Cost of sales = Calculated revenue + Estimated loss

2.6 Rectification costs

Where costs are incurred to rectify errors, and these costs are not recoverable from the customer, these costs should not be included in the profit calculation, but should instead be recognised in full as period costs as they are incurred.

2.7 Unknown future costs

Where it is not possible to calculate costs necessary to complete the contract, revenue may only be recognised up to the value of recoverable costs incurred to date, leaving a nil profit.

Example 3

Construction contract

On 1 January 20X4 Nim entered into a contract with a customer to construct a specialised building for an agreed price of $30 million.

At 31 December 20X4, Nim had incurred costs of $14 million and estimated that costs to complete the contract would amount to a further $7 million. Nim measures progress towards contract completion using the input method, based on costs incurred.

At 31 December Nim had invoiced $12 million to the customer.

How should the above contract be reflected in the financial statements of Nim for the year ended 31 December 20X4?

Through your presentation of this information, this example allows you to demonstrate your knowledge of financial information presentation.

Solution

Nim statement of profit or loss for the year ended 31 December 20X4

	$m
Revenue	
Cost of sales	
Gross profit	

Nim statement of financial position 31 December 20X4

	$m
Current assets	
Contract asset	

Workings

Notes

3 Performance obligation satisfied at a point in time

3.1 Performance obligation satisfied at a point in time

If a performance obligation is not satisfied over time then it is satisfied at a point in time. This is normally when the customer obtains control of the asset.

Notes

Example 4

Combined sale

On 1 September 20X7 Selby sold a machine including two year's technical support for $396,000. It usually sells the machine for $300,000 but does not sell technical support for this machine as a stand-alone product. Other support services offered by Selby earn a mark-up of 40%. It is expected that the technical support will cost Selby $50,000 per year.

Required:

How much revenue was earned by Selby in the year to 31 December 20X7?

Solution

Notes

3.2 Specific transactions

Certain types of sale transaction are specified within the FR syllabus:

- Consignment inventory
- Repurchase agreements
- Bill-and-hold arrangements
- Principal and agent.

3.2.1 Consignment inventory

Where goods are provided to a customer on consignment, it is important to identify whether the seller or the buyer has **control** in order to establish whether revenue may be recognised.

Illustration 4

On 1 January 20X6 Gillingham, a manufacturer, entered into an agreement to provide Canterbury, a retailer, with machines for resale.

The terms of the agreement were as follows:

- Canterbury pays the cost of insuring and maintaining the machines.
- Canterbury can display the machines in its showrooms and use them as demonstration models.
- When a machine is sold to a customer, Canterbury pays Gillingham the factory price at the time the machine was originally delivered.
- All machines remaining unsold six months after their original delivery must be purchased by Canterbury at the factory price at the time of delivery.
- Canterbury can return unsold machines to Gillingham at any time during the six-month period, without penalty. In practice, this has never happened.

At 31 December 20X6 the agreement is still in force and Canterbury holds several machines which were delivered less than six months earlier.

How should these machines be treated in the accounts of Canterbury for the year ended 31 December 20X6?

Notes

3.2.2 Repurchase agreements

A repurchase agreement is where an entity sells an asset and promises (or has the right) to repurchase the asset. This is not recognised as a sale, and there are generally three forms of repurchase agreements:

- obligation to repurchase
- right to repurchase
- obligation to repurchase at customer's request.

If an entity has an obligation or a right to repurchase the asset, the customer is not able to obtain substantially all of the remaining benefits from the asset, so does not obtain control of the asset, and accounts for such a repurchase contract as either:

- A lease, if the repurchase price is less than the original selling price.
- A financing arrangement, if the repurchase price is more than the original selling price.

Illustration 5

Xavier sells its head office, which cost $10 million, to Yorrick, a bank, for $10 million on 1 January 20X2. Xavier has the option to repurchase the property on 31 December 20X5, four years later, at $12 million. The head office was valued at transfer on 1 January 20X2 at $18 million and is expected to rise in value throughout the four-year period.

Giving reasons, show how Xavier should record the above during the first year following transfer.

3.2.3 Bill-and-hold arrangements

A bill-and-hold arrangement is a contract under which an entity invoices a customer for a product but the product is physically retained by the entity until it is transferred to the customer at some point in the future.

For this to be recognised within revenue, the customer must have obtained **control** of the product, despite it physically remaining with the entity.

Illustration 6

On 31 December 20X1, Clarence sold a machine plus spare parts to Edgar for $500,000. The value of the machine was $480,000, with the value of the spare parts being $20,000. Clarence delivered the machine on 31 December 20X1, but was asked to hold the spare parts by Edgar, due to Clarence's warehouse being in close proximity to Edgar's factory. Clarence expects to hold the spare parts for 2–4 years.

The parts are kept separately in the warehouse, cannot be used or sold by Clarence, and are ready for immediate shipment at Edgar's request. Clarence agreed to the transaction as it decided that holding costs would be insignificant.

Required:

Explain the financial reporting treatment for the issues for the year ended 31 December 20X1.

3.2.4 Principal and agent

If an entity is an agent, then revenue is recognised based on the fee or commission to which it is entitled.

Illustration 7

Rosemary Co's revenue includes $2 million for goods it sold acting as an agent for Elaine. Rosemary Co earned a commission of 20% on these sales and remitted the difference of $1.6 million (included in cost of sales) to Elaine.

How should the agency sale be treated in Rosemary's statement of profit or loss?

Notes

Illustrations and further practice

Notes

Questions

Notes

Chapter 11

Leases

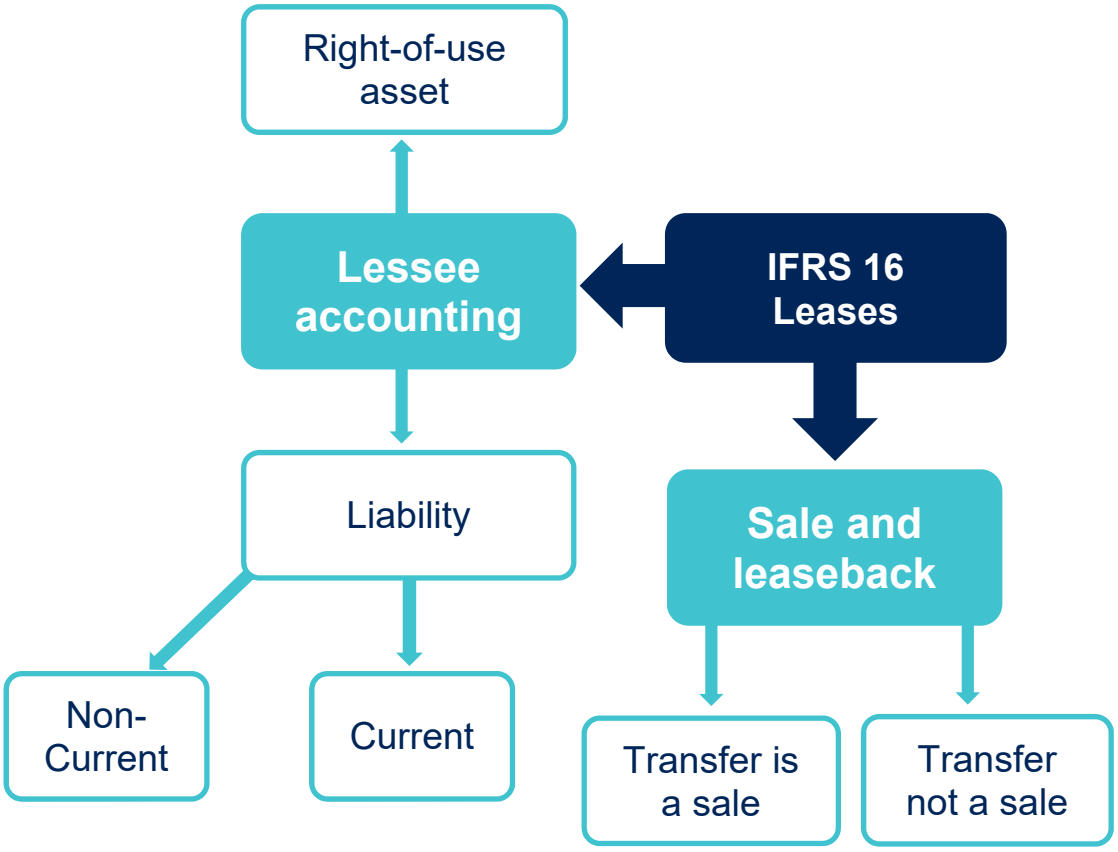
Outcome

By the end of this session you should be able to:

- account for right-of-use assets and lease liabilities in the records of the lessee
- explain the criteria for exemption from right-of-use asset recognition
- account for sale and leaseback agreements

and answer questions relating to these areas.

Overview


Right-of-use asset
Lessee accounting
IFRS 16 Leases
Liability
Sale and leaseback
Non-Current
Current
Transfer is a sale
Transfer not a sale

1 Leases

1.1 Definitions

A **lease** is a '**contract that conveys the right to use an underlying asset for a period of time in exchange for consideration**'.

The **lessor** is the '**entity that provides the right to use an underlying asset in exchange for consideration**'.

The **lessee** is the '**entity that obtains the right to use an underlying asset in exchange for consideration**'.

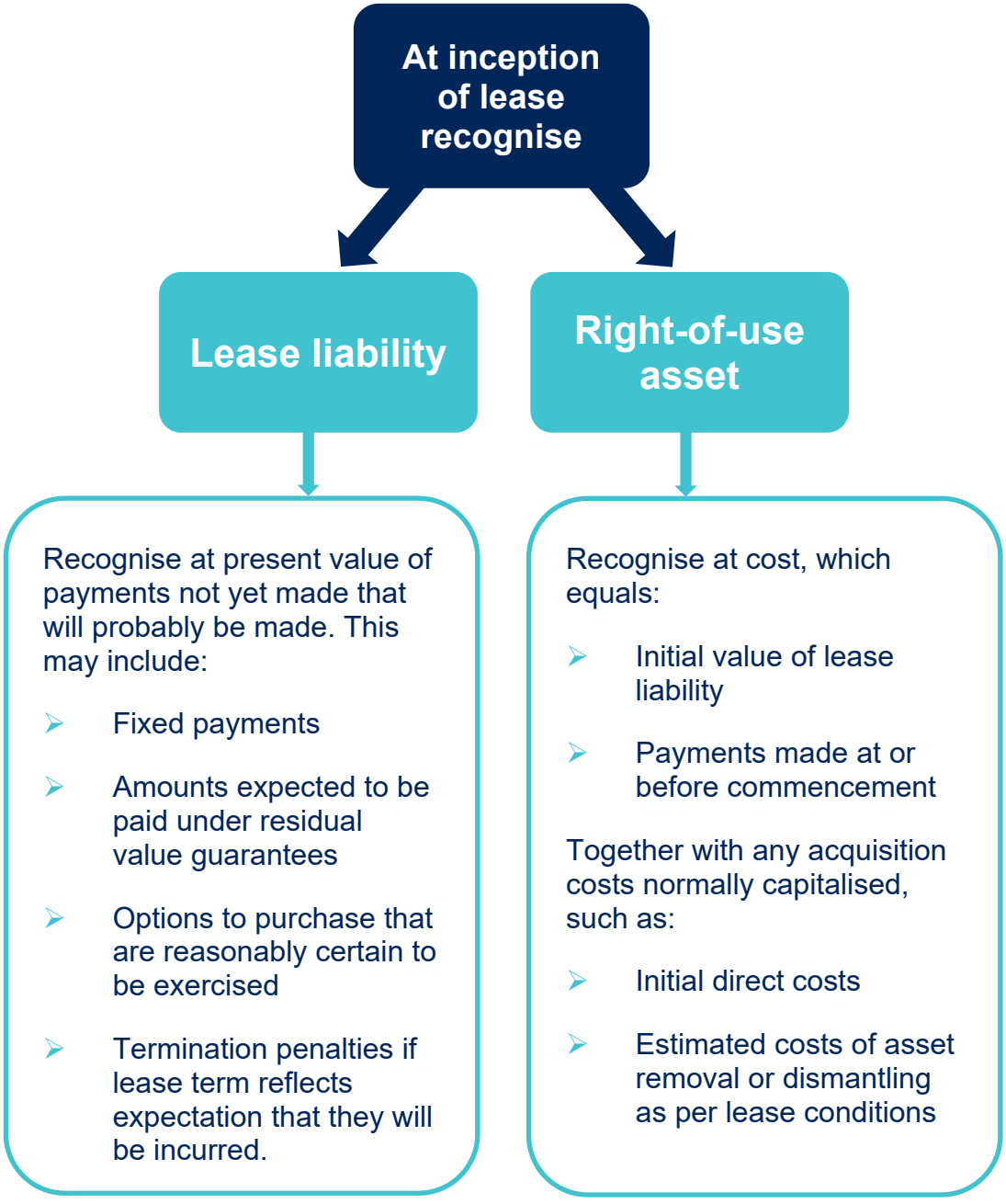
A **right-of-use** asset '**represents a lessee's right to use an underlying asset for the lease term**'.

(IFRS 16, Appendix A)

Notes

2 Lessee accounting

2.1 Measurement


At inception of lease recognise
Lease liability
Right-of-use asset
Recognise at present value of payments not yet made that will probably be made. This may include:
Fixed payments
Amounts expected to be paid under residual value guarantees
Options to purchase that are reasonably certain to be exercised
Termination penalties if lease term reflects expectation that they will be incurred.
Recognise at cost, which equals:
Initial value of lease liability
Payments made at or before commencement
Together with any acquisition costs normally capitalised, such as:
Initial direct costs
Estimated costs of asset removal or dismantling as per lease conditions

For FR purposes it is likely that the lease liability will simply comprise fixed payments and that the value of the right-of-use asset will equal the lease liability plus payments made at commencement.

Notes

Example 1

Initial values

On 1 January 20X1, Dynamic entered into a two-year lease for a lorry. The contract contains an option to extend the lease term for a further year. Dynamic believes that it is reasonably certain to exercise this option. Lorries have a useful life of ten years.

Lease payments are $10,000 per year for the initial term and $15,000 per year for the option period. All payments are due at the end of the year. To obtain the lease, Dynamic incurred initial direct costs of $3,000. Dynamic's rate of borrowing is 5%.

Calculate the initial carrying amount of the lease liability and the right-of-use asset and provide the double entries needed to record these amounts in Dynamic's financial records.

The lease liability is calculated as follows:

Date	Cash flow $	Discount rate	Present value $

The initial cost of the right-of-use asset is calculated as follows:

	$
Initial liability value	
Direct costs	

The double entries to record this are as follows:

Dr Right-of-use asset

Cr Lease liability

Dr Right-of-use asset

Cr Cash

Notes

2.2 Subsequent measurement: liability

The liability is increased by the interest charge, which is also recorded in the statement of profit or loss:

Dr Finance costs (SPL) **X**

Cr Lease liability **X**

Cash payments reduce the lease liability:

Dr Lease liability **X**

Cr Cash **X**

This is usually best shown using a lease liability table, showing payments, finance costs and balances. The layout will vary depending on whether lease payments are made in advance or arrears. For example:

Arrears

	Balance b/f	Interest @ 8%	Paid	Balance c/f
20X4	24,000	1,920	(7,250)	18,670

Advance

	Balance b/f	Paid	Net	Interest @ 10%	Balance c/f
20X4	24,000	(6,875)	17,125	1,713	18,838

2.3 Subsequent measurement: right-of-use asset

Unless another model is chosen, the cost model is used. The asset will be measured at cost less accumulated depreciation and impairment losses.

2.4 Statement of financial position presentation

The lease liability is split on the statement of financial position between its current and non-current elements. The easiest way to do this is to calculate the non-current element, with the current element calculated as the balancing figure.

The non-current element is calculated by calculating the liability remaining immediately after next year's lease payment. This principle may be applied whether the lease payments are in advance or arrears.

Notes

Example 2

Leased asset – payments in advance

On 1 April 20X7, Sima entered into an agreement to lease an item of equipment. The lease required four annual payments in advance of $215,000 each commencing on 1 April 20X7. The equipment has a useful life of four years and will be scrapped at the end of the lease period. The present value of the **total** lease payments is $750,000 and the interest rate implicit in the lease is 10%.

How will this be reflected within the financial statements of Sima for the year ended 31 March 20X8?

Through your presentation of this information, this example allows you to demonstrate your knowledge of financial information presentation.

Notes

Example 3

Leased asset – payments in arrears (same scenario as Example 1)

On 1 January 20X1, Dynamic entered into a three-year lease for a lorry. Lease payments are $10,000 per year for the first two years and $15,000 for the third year. All payments are due at the end of the year. The present value of the lease payments was $31,552, and Dynamic incurred initial direct costs of $3,000. Dynamic's rate of borrowing is 5%.

Prepare extracts from Dynamic's financial statements in respect of the lease agreement for the year ended 31 December 20X1.

Notes

2.5 Short-life and low value assets

If the lease is short-term (12 months or less at the inception date) or of a low value then a simplified treatment is allowed.

Example 4

Short-life and low value assets

Mayfly Co entered into a lease agreement for a piece of manufacturing equipment on 1 October 20X2, for a period of 12 months at a monthly payment of $4,000, after an initial payment-free period of 3 months, the first payment being made on 1 January 20X3. Mayfly Co is applying the short-term lease exemption permitted under IAS16 Leases.

How much should Mayfly Co recognise as an expense for the manufacturing equipment in the statement of profit or loss for the year ended 31 March 20X3?

A. $12,000

B. $18,000

C. $24,000

D. $48,000

3 Sale and leaseback

3.1 Is the transfer a 'sale'?

If an entity transfers an asset to another entity and then leases it back, the accounting treatment will depend upon whether the transaction is a sale or not.

In order for the transaction to be treated as a sale, the seller must apply IFRS 15 *Revenue from Contracts with Customers* (see Chapter 11) to decide whether a performance obligation has been satisfied, critically whether control of the asset has been passed to the buyer.

If a performance obligation has been satisfied, the transaction will be treated as a sale. If the transaction is not a sale then the asset would be retained, and the sale proceeds would be treated as a loan.

3.2 Accounting treatment

Transfer is not a sale	Transfer is a sale

The right-of-use asset is calculated as:

(Lease liability / Sale proceeds) × Carrying amount of asset

The profit or loss on disposal is simply the balancing figure after the sale proceeds have been debited to the bank, the asset has been derecognised, and the right-of use asset and lease liability have been recognised. This figure can also be proved, see the answer to Example 5 below.

Within FR, the sale proceeds for a sale and leaseback will only ever represent the fair value of the asset. As you progress to Strategic Business Reporting you will discover what happens when this is not the case.

Example 5

Sale and leaseback – transfer is a sale

On 1 January 20X1, Painting sells an item of machinery to Collage for its fair value of $3 million. The asset had a carrying amount of $1.2 million prior to the sale. This sale represents the satisfaction of a performance obligation, in accordance with IFRS 15 Revenue from Contracts with Customers. Painting enters into a contract with Collage for the right to use the asset for the next five years. Annual payments of $500,000 are due at the end of each year. The interest rate implicit in the lease is 10%.

The present value of the annual lease payments is $1.9 million. The remaining useful life of the machine is much greater than the lease term.

Explain how Painting will account for the transaction on 1 January 20X1.

Through your explanation, this example allows you to demonstrate your knowledge of financial information, as well as your communication and problem solving skills.

Notes

Questions

Chapter 12

Financial assets and financial liabilities

Outcome

By the end of this session you should be able to:

- explain the need for an accounting standard on financial instruments
- define financial instruments in terms of financial assets and financial liabilities
- indicate how the following categories of financial instrument should be measured and how gains and losses should be treated:
  - amortised cost
  - fair value through other comprehensive income
  - fair value through profit or loss
- distinguish between debt and equity capital
- apply the requirements of relevant accounting standards to the issue and finance costs of:
  - equity
  - redeemable preference shares and debt with no conversion rights
  - convertible debt
- explain and account for the factoring of receivables

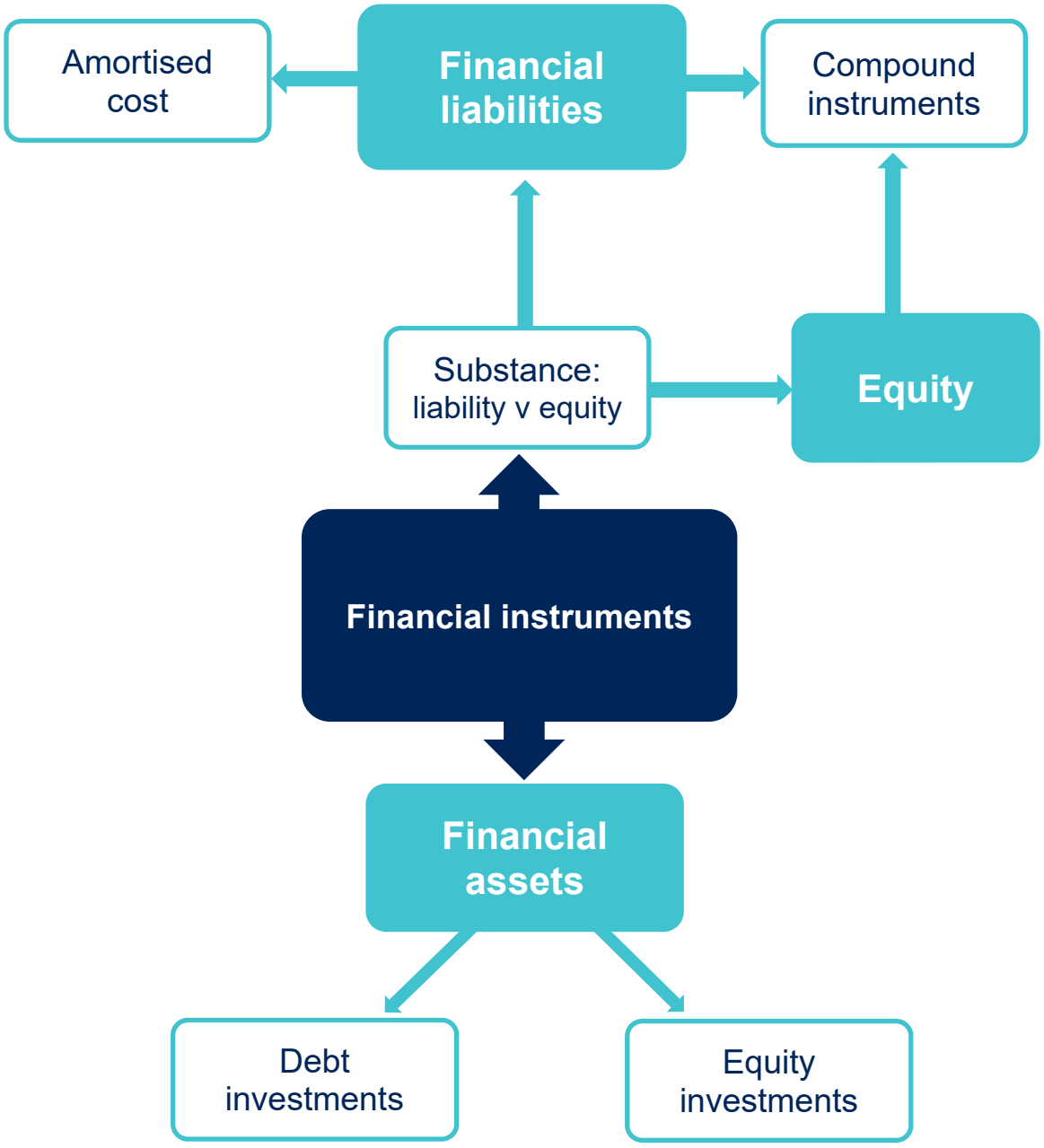
and answer questions relating to these areas.

Chapter 12

PER

One of the PER performance objectives (PO6) is to record and process transactions and events. You use the right accounting treatments for transactions and events. These should be both historical and prospective – and include non-routine transactions. Working through this chapter should help you understand how to demonstrate that objective.

Overview


Amortised cost
Financial liabilities
Compound instruments
Substance: liability v equity
Equity
Financial instruments
Financial assets
Debt investments
Equity investments

1 Financial instruments

1.1 Financial instrument definitions

A **financial instrument** is a contract that '**gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity**' (IAS 32, para 11).

A **financial asset** is:

- **'Cash**
- **An equity instrument of another entity**
- **A contractual right to receive cash or another financial asset**
- **A contractual right to exchange financial assets or liabilities on favourable terms'** (IAS 32, para 11).

A **financial liability** is:

- **'A contractual obligation to deliver cash or another financial asset**
- **A contractual obligation to exchange financial assets or liabilities on unfavourable terms'** (IAS 32, para 11).

Notes

1.2 Debt or equity?

When issuing a financial instrument, an entity must classify it as a financial liability or as equity according to its substance.

The decision as to whether a financial instrument is a financial liability or equity has a big impact on the financial statements.

The instrument will be classified as a liability when the issuing entity has **any obligation to make payments** in respect of the instrument, whether this relates to capital, dividend or interest.

The treatment of interest and dividends relating to a financial instrument must also follow the treatment of the instrument itself.

Illustration 1

Debt or equity?

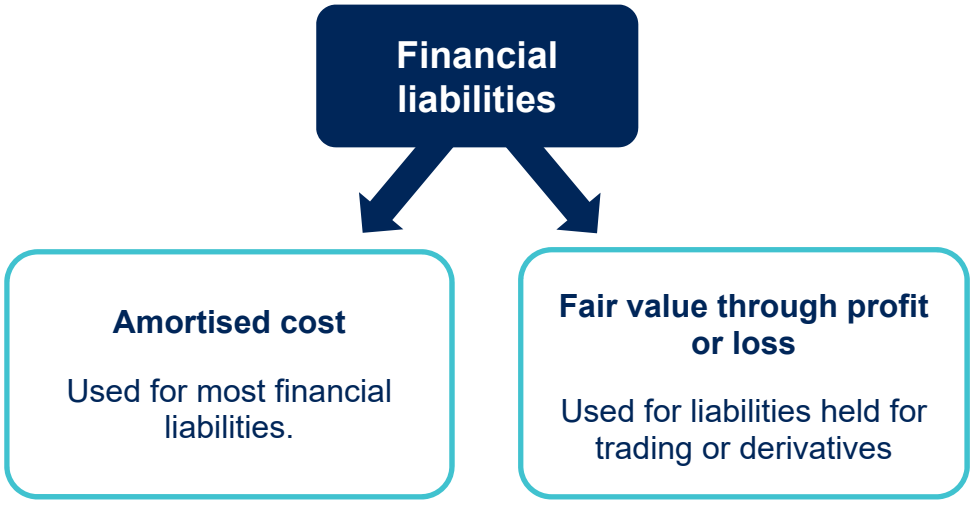
On 1 April 20X2 Wellington issues $30 million of 8% preference shares, to be redeemed at par on 31 March 20X7.

Wellington has an obligation to repay the $30 million and also to pay 8% dividend each year.

Notes

2 Financial liabilities

2.1 Categories


Financial liabilities
Amortised cost
Used for most financial liabilities.
Fair value through profit or loss
Used for liabilities held for trading or derivatives

Note that within Financial Reporting you will only see liabilities measured using amortised cost.

Notes

2.2 Amortised cost

The accounting treatment of financial liabilities measured at amortised cost is as follows:

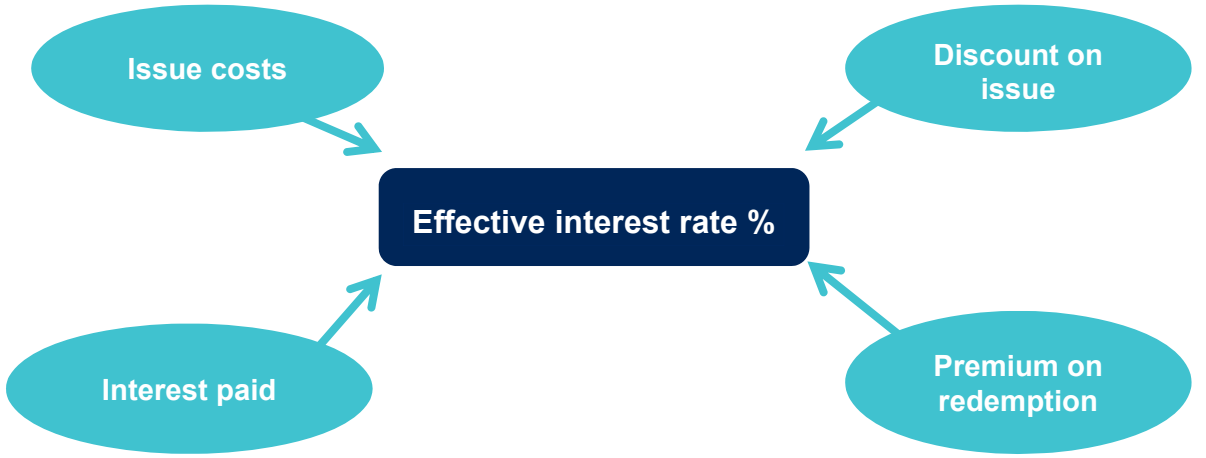
They are **initially** recognised at **fair value** (normally the proceeds received) less any transaction costs (such as legal or broker fees).

They are **subsequently** measured at amortised cost:

The **effective rate** of interest spreads all of the costs of the liability (such as transaction fees, issue discounts, annual interest payments and redemption premiums) to profit or loss over the term of the instrument.

Amortised cost = initial value + effective interest – interest paid

2.3 Effective interest rate



Notes

2.4 Amortised cost table

The following table is useful for working out the carrying amount of a liability that is measured at amortised cost:

Reporting period	Opening amount[1]	Interest charged[2]	Interest paid[3]	Closing amount
Year ended 31 December 20X1	X	X	(X)	X

1 In the first year of the liability, the initial value will be its fair value less transaction costs.

2 Interest is charged using the effective rate of interest on the balance brought forward.

3 Cash interest payments are normally based on the nominal or par value of the liability and the nominal or coupon rate of interest.

Notes

Example 1

Amortised cost

On 1 January 20X5 a 5% loan note is issued for $5,000. The loan is redeemable after three years at a premium of $487, giving an effective rate of interest of 8%. Interest is paid annually in arrears.

Required:

Show how the value of the loan note changes over its life.

Notes

Example 2

Anil Co issues 4% loan notes with a nominal value of $20,000.

The loan notes are issued at a discount of 2.5% and $534 of issue costs are incurred.

The loan notes will be repayable at a premium of 10% after 5 years. The effective rate of interest is 7%. Interest is payable annually in arrears.

What amount will be recorded as a financial liability when the loan notes are issued?

What amounts will be shown in the statement of profit or loss and statement of financial position for year 1?

3 Compound instruments

3.1 Substance over form

A compound instrument is one that has characteristics of both a financial liability and equity. A common example is the issue of a bond or loan that allows the holders the choice of redemption in the form of cash or a fixed number of equity shares.

IAS 32 specifies that compound instruments must be split into:

- a **liability component** (the obligation to repay cash)
- an **equity component** (the obligation to issue a fixed number of shares).

3.2 Convertible loan

- a convertible loan may be repaid, at the lender's option, with equity shares instead of cash
- the terms of conversion are fixed at the inception of the loan
- the lender will accept a rate of interest below the market rate for similar non-convertible loans, due to the potential for gain on the conversion.

3.3 Split accounting

The split of the liability component and the equity component at the issue date is calculated as follows:

- the liability component is the present value of the cash repayments of interest and capital, discounted **using the market rate** for non-convertible bonds
- the equity component is the difference between the cash received and the liability component at the issue date.

After initial recognition, the liability will be measured at **amortised cost**. The equity component is not remeasured and remains unchanged within the equity section of the statement of financial position.

Illustration 2

Compound instrument

On 1 April 20X7 Hybrid Co issued a 4% convertible loan note for $10,000. Interest is payable annually in arrears and the loan is repayable after three years for cash of $10,000 or may be converted to equity. The market rate for loans with no conversion option is 7%.

Discount factors are as follows:

Year	Discount factor at 4%	Discount factor at 7%
1	0.96	0.93
2	0.92	0.87
3	0.89	0.82

In order to split the loan we first need to determine the fair value of the liability using the market interest rate applied to the cash flows. The equity element is then the balancing figure.

Year	Cash flow	Discount factor	Present value
1			
2			
3			
			_____
	Liability		
	Equity (balancing figure)		
			_____
	Loan value		
			_____

The equity element of $752 remains on the statement of financial position without remeasurement until redemption. The liability is carried at amortised cost, charging market-rate interest:

	Balance b/f	Interest @ 7%	Paid ($10,000 × 4%)	Balance c/f
Year to 31 March 20X8				

Extracts from the financial statements for the year ended 31 March 20X8 would show:

Statement of profit or loss	$
Finance cost	
Statement of financial position	
Equity – conversion option	
Non-current liability – 4% convertible loan	

Notes

Example 3

Compound instrument

On 1 January 20X5 a 5% convertible loan note is issued for $5,000. The loan is repayable after three years for cash of $5,000 or may be converted to equity. The market rate for loans with no conversion option is 8%.

Discount factors are as follows:

Year	Discount factor at 5%	Discount factor at 8%
1	0.95	0.93
2	0.91	0.86
3	0.86	0.79

Required:

(i) Split the loan at inception between equity and liability

(ii) Show extracts from the financial statements for the year ended 31 December 20X5.

Through your preparation of these calculations and extracts, this example allows you to demonstrate your knowledge of standards and principles that apply to IFRS Standards.

Notes

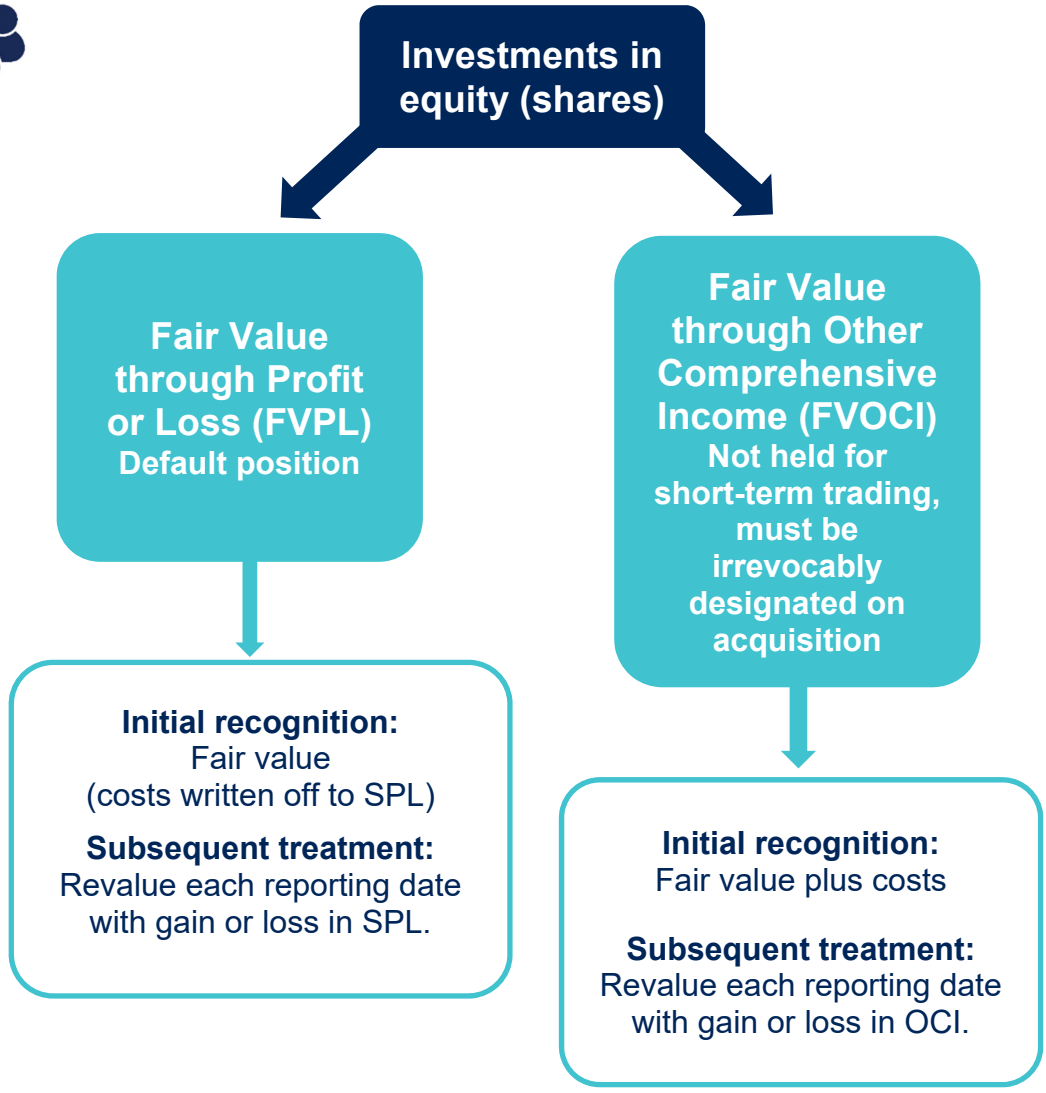
Notes

Illustrations and further practice

Notes

4 Financial assets

4.1 Classification and measurement: investments in equity


Investments in equity (shares)
Fair Value through Profit or Loss (FVPL)
Default position
Fair Value through Other Comprehensive Income (FVOCI)
Not held for short-term trading, must be irrevocably designated on acquisition
Initial recognition:
Fair value
(costs written off to SPL)
Subsequent treatment:
Revalue each reporting date with gain or loss in SPL.
Initial recognition:
Fair value plus costs
Subsequent treatment:
Revalue each reporting date with gain or loss in OCI.

Notes

Example 4

Equity investment

On 21 November 20X6 Han Co invested in 6,000 ordinary shares of a listed company at a cost of $2.70 per share, plus transaction costs of $324.

At 31 December 20X6 the shares have a market value of $2.95 per share.

Required:

Show the impact of the above transaction on the statement of profit or loss and statement of financial position for the year ended 31 December 20X6.

Notes

4.2 Classification: investments in debt

IFRS 9 specifies **three** ways of classifying debt investments:

- Amortised cost
- Fair value through other comprehensive income
- Fair value through profit or loss.

A financial asset is measured at **amortised cost** if:

- The objective of the business model within which the asset is held is to **hold the asset to maturity** to collect the contractual cash flows
- The contractual terms of the asset give rise to cash flows that are solely **repayments of principal** and **interest of the principal amount outstanding**. Interest payments should offer adequate compensation for risk and the time value of money.

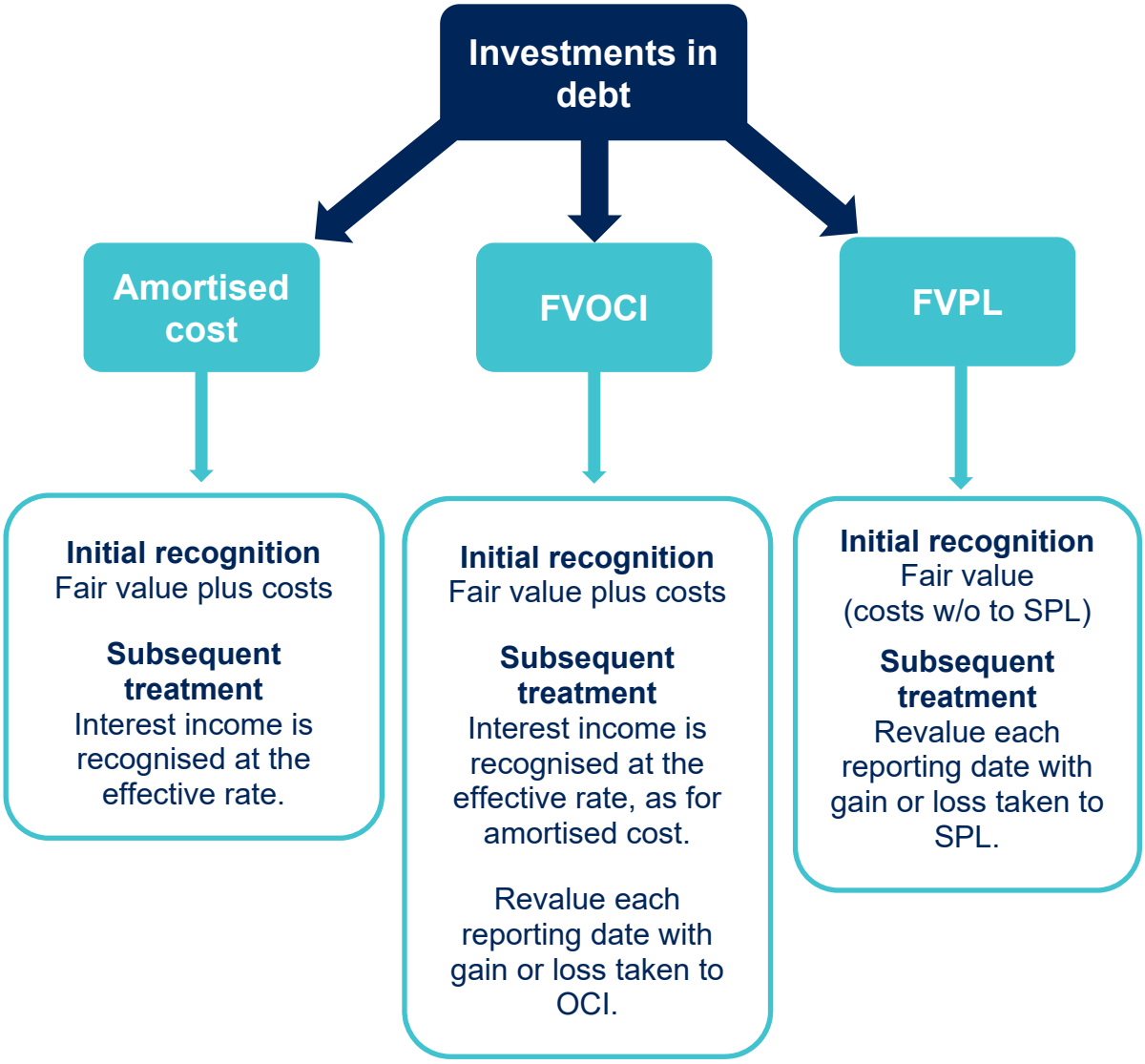
A financial asset is measured at fair value through other comprehensive income if:

- The objective of the business model within which the asset is held is to both **collect contractual cash flows** but also to increase returns when possible by **selling the asset**
- The contractual terms of the asset give rise to cash flows that are solely **repayments of principal** and **interest of the principal amount outstanding**.

If not classified as one of the above two categories, the financial asset is measured at **fair value through profit or loss**.

Notes

4.3 Measurement: investments in debt


Investments in debt
Amortised cost
FVOCI
FVPL
Initial recognition
Fair value plus costs
Subsequent treatment
Interest income is recognised at the effective rate.
Initial recognition
Fair value plus costs
Subsequent treatment
Interest income is recognised at the effective rate, as for amortised cost.
Revalue each reporting date with gain or loss taken to OCI.
Initial recognition
Fair value
(costs w/o to SPL)
Subsequent treatment
Revalue each reporting date with gain or loss taken to SPL.

Notes

Example 5

Debt investment

On 1 January 20X1, Tokyo bought a $100,000 5% bond for $95,000, incurring acquisition costs of $2,000. Interest is received annually in arrears. The bond will be redeemed at a premium of $5,960 over nominal value on 31 December 20X3. The effective rate of interest is 8%. The fair value of the bond at 31 December 20X1 was $110,000.

Explain, with calculations, how the bond will be accounted for in the year ended 31 December 20X1 if:

(a) Tokyo planned to hold the bond until the redemption date.

(b) Tokyo may sell the bond if the possibility of an investment with a higher return arises.

(c) Tokyo planned to trade the bond in the short-term.

Through your explanation and calculations, this example allows you to demonstrate your knowledge of standards and principles that apply to IFRS Standards.

Notes

Illustrations and further practice

Notes

5 Derecognition

5.1 Financial liability derecognition

A financial liability should be derecognised when the obligation is **extinguished**. This may happen when the contract:

- is discharged, or
- is cancelled, or
- expires.

The difference between any consideration transferred and the carrying amount of the financial liability is recognised in profit or loss.

5.2 Financial asset derecognition

A financial asset should be derecognised when:

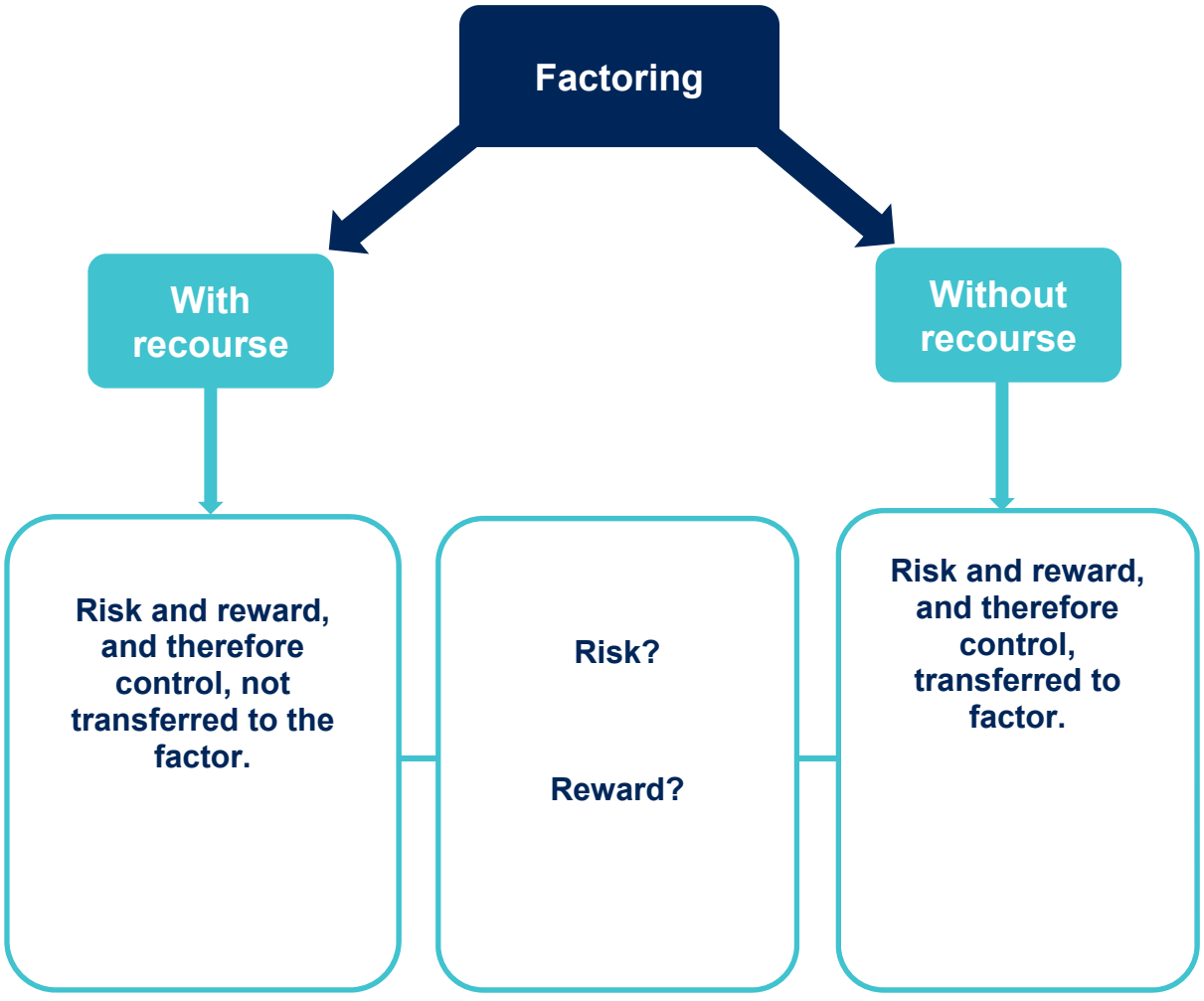
- the contractual rights to the cash flows expire, or
- the entity transfers **substantially all of the risks and rewards** of the financial asset to another party.

The difference between any consideration received and the carrying amount of the financial asset is recognised in profit or loss.

Notes

6 Factoring

6.1 Factoring overview



Illustrations and further practice

Questions

Chapter 13

Taxation

Outcome

By the end of this session you should be able to:

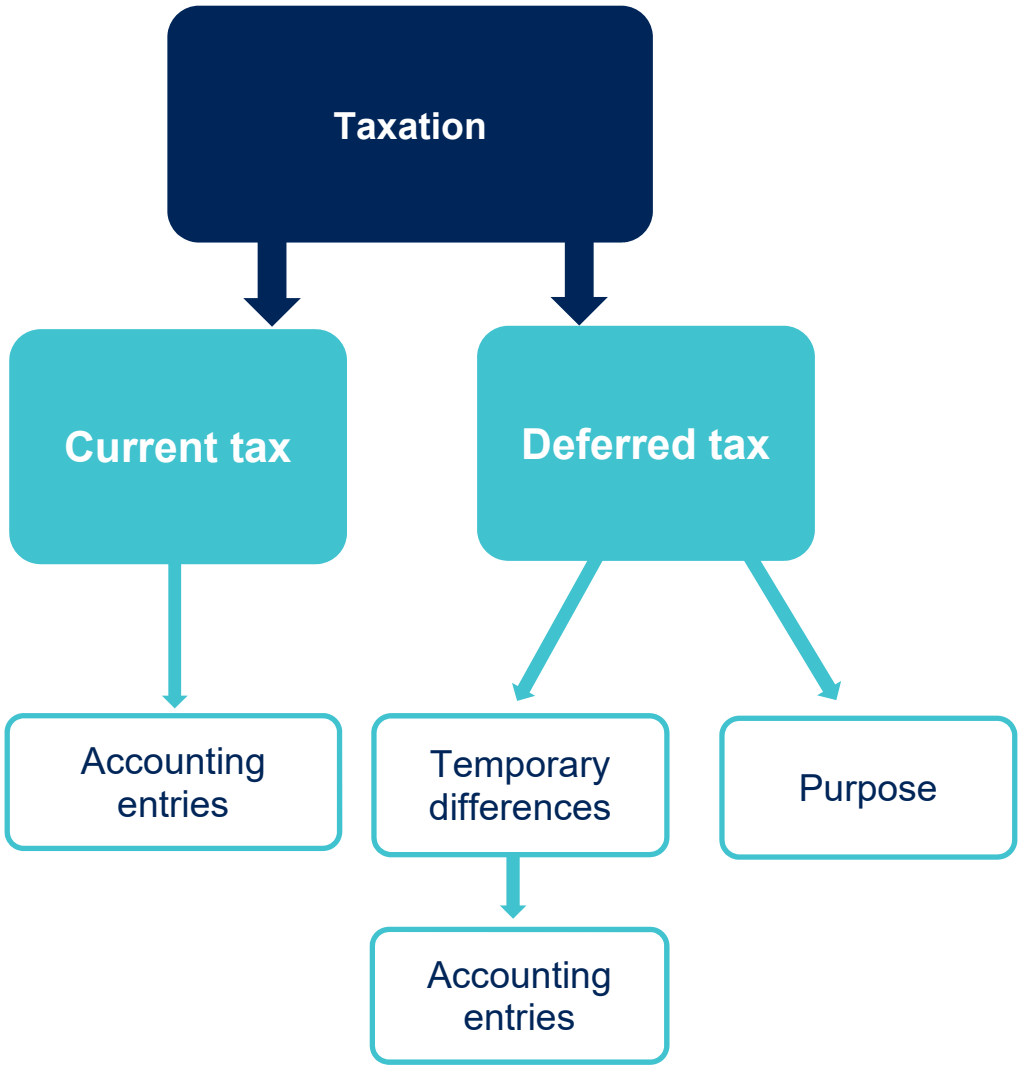
- account for current taxation
- explain the effect of temporary differences on accounting and taxable profits
- compute and record deferred tax amounts in the financial statements

and answer questions relating to these areas.

PER

One of the PER performance objectives (PO6) is to record and process transactions and events. You use the right accounting treatments for transactions and events. These should be both historical and prospective – and include non-routine transactions. Working through this chapter should help you understand how to demonstrate that objective.

Overview


Taxation
Current tax
Deferred tax
Accounting entries
Temporary differences
Purpose
Accounting entries

1 Tax

1.1 Tax in the financial statements

The tax expense in the financial statements is made up of two elements:

- **Current tax** – tax payable to authorities in relation to current year activities, together with any under- or over-provision from the previous year
- **Deferred tax** – an application of the accruals concept.

The tax liability brought forward will usually be paid during the year. If the payment is not the same as the liability, this will leave a balance on the trial balance at the year-end. This balance represents an under- or over-provision and is written off to profit or loss as part of the current year expense.

Tax expense in SPL = current tax +/– movement in deferred tax

1.2 Accounting for current tax

The accounting entry to record current tax is:

Dr Tax expense (SPL)	X	
Cr Tax payable (SFP)		X

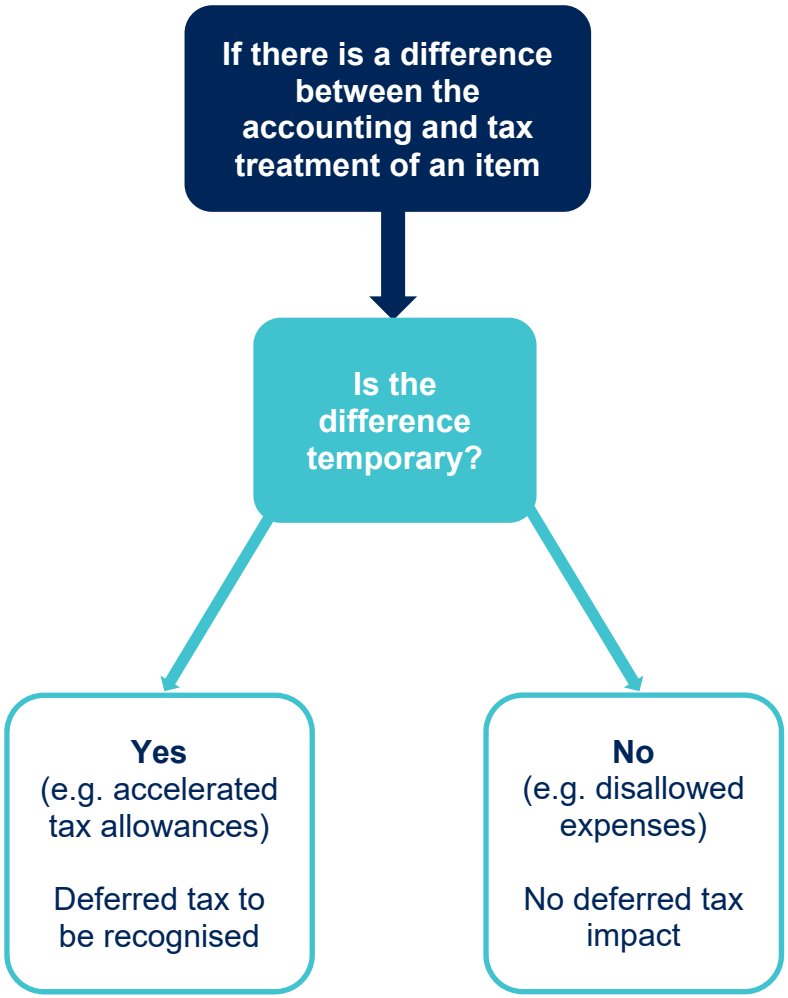
Note that the current liability for taxation will only ever represent the estimate based on current year profit.

Notes

2 Deferred tax

2.1 What is deferred tax?

Deferred tax is an application of the **accruals concept**. The liability for deferred tax recognises the estimated future tax consequences of recognised transactions and events.


If there is a difference between the accounting and tax treatment of an item
Is the difference temporary?
Yes
(e.g. accelerated tax allowances)
Deferred tax to be recognised
No
(e.g. disallowed expenses)
No deferred tax impact

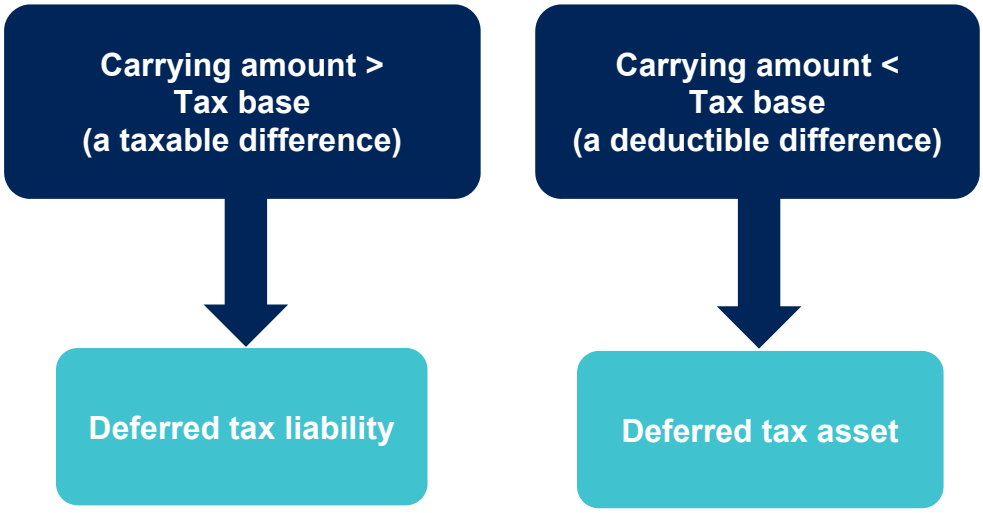
Notes

2.2 Calculating temporary differences

Deferred tax is calculated by comparing the carrying amount of an asset or liability to its tax base.

The **tax base** of an asset or liability is its value for tax purposes.

It is important to consider whether the carrying amount or the tax base is the larger figure:


Carrying amount > Tax base (a taxable difference)
Carrying amount < Tax base (a deductible difference)
Deferred tax liability
Deferred tax asset

Notes

Example 1

Deferred tax liability

On 1 April 20X2 Wilf bought a machine for $200,000. Wilf depreciated the machine over its estimated life of 4 years on a straight line basis. The machine attracted an initial tax allowance of 100%, and Wilf's rate of tax is 30%.

Explain the impact of deferred tax on Wilf's financial statements for the years ended 31 March 20X3 and 20X4.

Through your explanation, this example allows you to demonstrate your communication skills.

Notes

Example 2

Deferred tax asset

Kaya Co introduced a warranty scheme during the year ended 31 December 20X6. Kaya Co's statement of financial position as at 31 December 20X6 showed a warranty provision of $86,000. For tax purposes warranty costs are deductible when claims are paid. The rate of tax is 20%.

Required:

What is the double entry necessary to record the deferred tax impact of the above warranty provision?

Notes

2.3 Recognition

Deferred tax liabilities should be recognised in respect of taxable temporary differences. For Financial Reporting this is likely to be limited to those arising on property, plant and equipment.

Deferred tax assets should be recognised in respect of deductible temporary differences as long as sufficient future profits will be available against which the deductible difference can be utilised.

Notes

2.4 Measurement

To calculate the deferred tax balance, the temporary difference is multiplied by the tax rate in force (or expected to be in force) when the asset is realised or the liability is settled.

When accounting for deferred tax, the entity accounts for the year-on-year movement in the deferred tax balance. This is **normally** recorded in profit or loss:

Increase in liability:		Increase in asset:	
Dr Tax expense (SPL)	X	Dr Deferred tax (SFP)	X
Cr Deferred tax (SFP)	X	Cr Tax expense (SPL)	X
Decrease in liability:		Decrease in asset:	
Dr Deferred tax (SFP)	X	Dr Tax expense (SPL)	X
Cr Tax expense (SPL)	X	Cr Deferred tax (SFP)	X

However, if the item giving rise to deferred tax is recorded in Other Comprehensive Income (OCI) (e.g. an asset revaluation, see 3.1), then the related deferred tax income or expense should also be presented in OCI.

Notes

Example 3

Taxation

King has the following items on its trial balance at 30 September 20X9.

	Dr	Cr
Deferred tax		17,000
Taxation	2,200	

The directors of King estimate that the provision necessary for tax on current year profit is $26,000. The difference between the carrying amount and lower tax base of King's net assets is $63,000. King's rate of income tax is 30%.

Required:

Show the impact of the above on the financial statements of King for the year ended 30 September 20X9.

Notes

Notes

3 Deferred tax: asset revaluation

3.1 Revaluations

Deferred tax should be recognised on asset revaluations, even if there is no intention to sell the asset.

Revaluation gains are recorded in other comprehensive income and so any deferred tax arising on the revaluation must also be recorded in other comprehensive income. This has the effect of reducing the gain recognised within other comprehensive income to a net of tax amount.

Notes

Example 4

Revaluation gain

On 31 December 20X7 Shinji revalued its land, recognising a gain of $60,000. Shinji's rate of tax is 30%.

Explain the impact of the gain, including deferred tax, on Shinji's financial statements for the year ended 31 December 20X7.

Illustrations and further practice

Notes

Questions

Chapter 14

Earnings per share

Outcome

By the end of this session you should be able to:

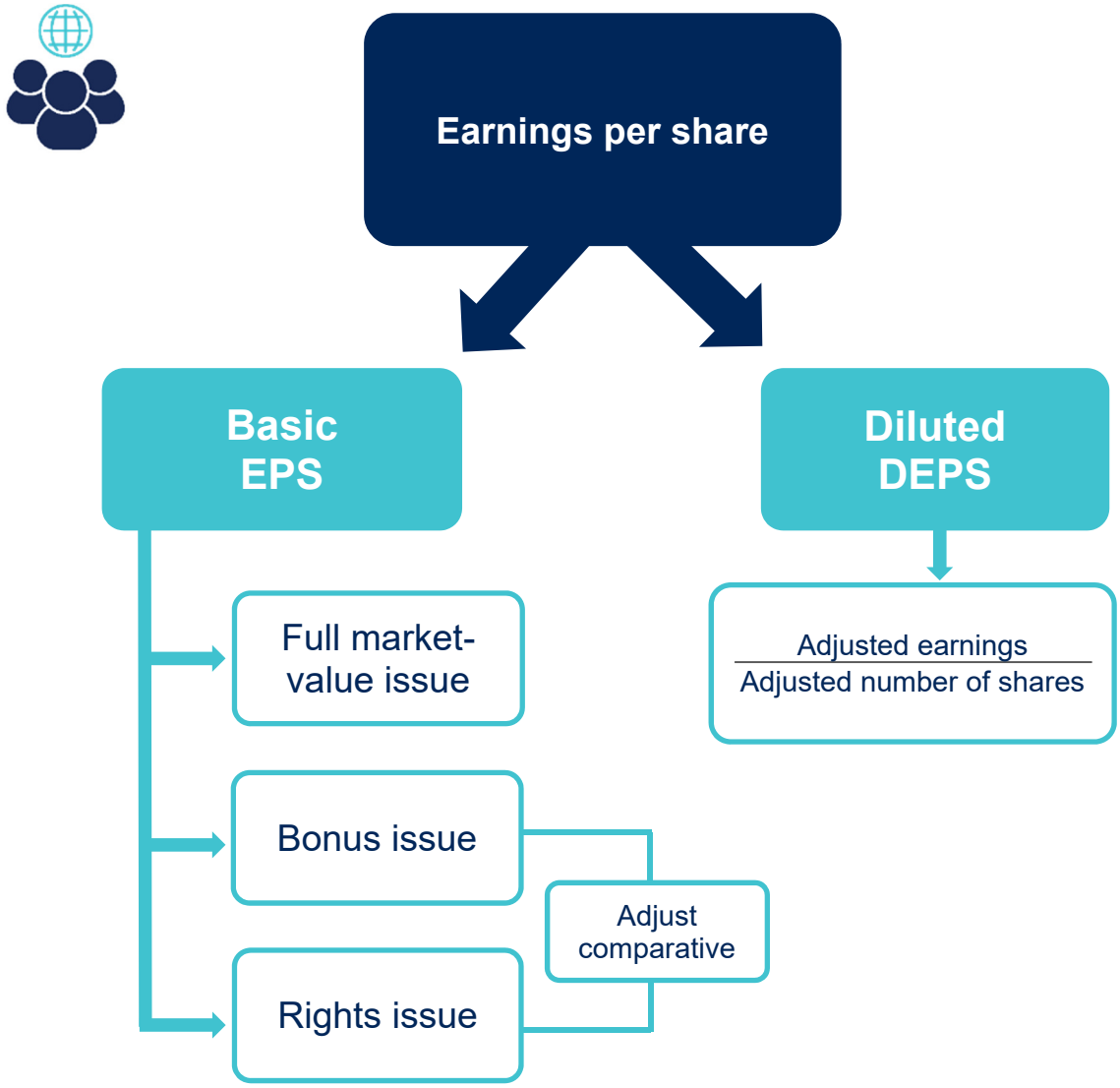
- calculate earnings per share (EPS) dealing with
  - full market value issues
  - bonus issues
  - rights issues
- explain the relevance of diluted earnings per share (DEPS) and calculate the DEPS involving convertible debt and share options

and answer questions relating to these areas.

PER

One of the PER performance objectives (PO6) is to record and process transactions and events. You use the right accounting treatments for transactions and events. These should be both historical and prospective – and include non-routine transactions. Working through this chapter should help you understand how to demonstrate that objective.

Overview


Earnings per share
Basic EPS
Diluted DEPS
Full market-value issue
Bonus issue
Rights issue
Adjust comparative
Adjusted earnings
Adjusted number of shares

1 Basic EPS

1.1 Basic calculation of EPS

$$\frac{\text{Earnings}}{\text{Number of ordinary shares}}$$

- Earnings = profit for year available to ordinary shareholders
- Number of shares = weighted average number of ordinary shares.

1.2 Weighted average number of shares

The calculation of weighted average will depend on the type of share issue:

- Full market value issue – use weighted average table
- Bonus issue – assume bonus shares issued with original shares, so in issue for whole of current year
- Rights issue – use weighted average table, with pre-issue shares adjusted for bonus element using rights issue bonus fraction.

1.3 Weighted average table pro-forma

	No of shares	× Fraction of year held	× Bonus fraction (if applicable)	= Weighted average
b/f	X	× X/12	× X	X
Issue	X			
Total	X	× X/12		X
			Weighted average =	X

Notes

Example 1

Full market value

Robert had 6,000 ordinary shares in issue on 1 January 20X3.

On 1 April 20X3 Robert issued 1,500 shares at full market value.

Robert's earnings for the year to 31 December 20X3 were $1,200.

Required:

Calculate Robert's earnings per share for the year to 31 December 20X3.

Through your calculation of this information, this example allows you to demonstrate your knowledge of standards and principles that apply to IFRS Standards.

Notes

1.4 Bonus issue fraction

If there is only a bonus issue during the year, then the bonus shares may be assumed to have been in issue for the whole year. Where there is more than one issue during the year it may be easier to use a weighted average table, multiplying the pre-issue number of shares by the bonus fraction. The bonus fraction will be

$$\frac{\text{New number of shares}}{\text{Old number of shares}}$$

Example 2

Bonus issue

Robert had 6,000 ordinary shares in issue on 1 January 20X3.

On 1 April 20X3 Robert issued 1,500 shares in a 1 for 4 bonus issue.

Robert's earnings for the year to 31 December 20X3 were $1,200.

Required:

Calculate Robert's earnings per share for the year to 31 December 20X3.

1.5 Calculation of rights issue bonus fraction

$$\text{Rights issue bonus fraction} = \frac{\text{actual market price per share}}{\text{theoretical ex-rights price (TERP)}}$$

The actual market price will be given in the question, but the TERP will need to be calculated, essentially as a weighted average value per share of the revised shareholding.

Illustration 1

Theoretical ex-rights price (TERP)

On 31 August 20X8 Chan Co made a 1 for 4 rights issue at a price of $4.70 when the market price per share was $6.

This means that for every 4 shares held (worth $6 each) a shareholder has the right to acquire one more share at $4.70.

The weighted average share value (or TERP) of the new total shareholding (5 shares) is calculated as follows:

	No of shares	Price per share $	Total value $
Original holding	4	6.00	24.00
Rights issue	1	4.70	4.70
New holding	5		28.70

The TERP is calculated as $28.70 ÷ 5 shares = $5.74

Notes

Example 3

Rights issue

Robert had 6,000 ordinary shares in issue on 1 January 20X3.

On 1 April 20X3 Robert issued 1,500 shares in a 1 for 4 rights issue at a price of $2.50 when the market price per share was $4.

Robert's earnings for the year to 31 December 20X3 were $1,200.

Required:

Calculate Robert's earnings per share for the year to 31 December 20X3.

1.6 Adjustment of comparatives

Where there is a bonus element to shares issued during the year (i.e. bonus or rights issue), this bonus element is deemed to have been issued at the same time as the original shares. In order to make a meaningful comparison we need to adjust the previous year's EPS. We do this by **multiplying the previous year's EPS by the inverse of the bonus fraction**. This gives the same result as multiplying the previous year's number of shares by the bonus fraction.

Note that the previous year's restated EPS is **always lower** than the original.

Notes

Example 4

Bonus issue

Robert had 6,000 ordinary shares in issue on 1 January 20X3.

On 1 April 20X3 Robert issued 1,500 shares in a 1 for 4 bonus issue.

Robert's earnings per share for the year ended 31 December 20X2, as originally calculated, was 18¢.

Required:

Calculate Robert's restated comparative earnings per share for the year to 31 December 20X2.

Rights issue

Robert had 6,000 ordinary shares in issue on 1 January 20X3.

On 1 April 20X3 Robert issued 1,500 shares in a 1 for 4 rights issue at a price of $2.50 when the market price per share was $4.

Robert's earnings per share for the year ended 31 December 20X2, as originally calculated, was 18¢.

Required:

Calculate Robert's restated comparative earnings per share for the year to 31 December 20X2.

Through your calculation of this information, this example allows you to demonstrate your knowledge of standards and principles that apply to IFRS Standards.

Illustrations and further practice

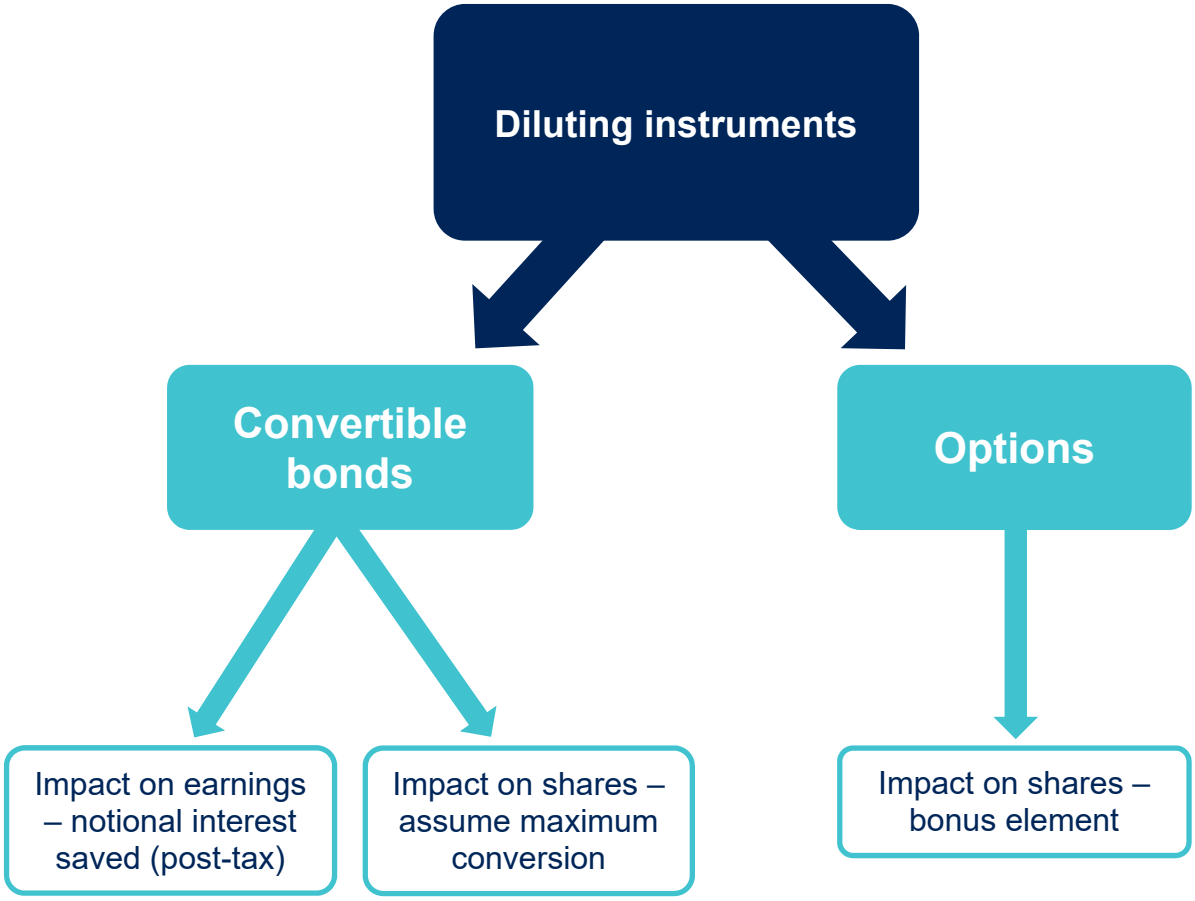
Notes

2 Diluted earnings per share (DEPS)

2.1 Purpose of DEPS

The purpose of DEPS is to show the potential impact on EPS of future share issues arising as a result of instruments in issue at the year-end. Instruments to be considered are convertible debt (loan stock, bonds etc.) and share options.

2.2 Impact of diluting instruments


Diluting instruments
Convertible bonds
Options
Impact on earnings – notional interest saved (post-tax)
Impact on shares – assume maximum conversion
Impact on shares – bonus element

Notes

Example 5

DEPS – Convertibles

Robert had 6,000 ordinary shares in issue throughout the year to 31 December 20X3.

At that date Robert also had in issue $5,000 convertible loan stock with an effective rate of interest of 10%. Robert's rate of income tax is 30%.

The loan is convertible into ordinary shares on the basis of 60 shares per $100 loan.

Robert's earnings for the year to 31 December 20X3 were $1,200.

Required:

Calculate Robert's diluted earnings per share for the year to 31 December 20X3.

Example 6

DEPS – options

Robert had 6,000 ordinary shares in issue throughout the year to 31 December 20X3.

At that date Robert also had in issue 2,000 share options. These options are exercisable at $1.20 per ordinary share. The average fair value per ordinary share during the year was $1.50.

Robert's earnings for the year to 31 December 20X3 were $1,200.

Required:

Calculate Robert's diluted earnings per share for the year to 31 December 20X3.

Through your calculation of this information, this example allows you to demonstrate your knowledge of standards and principles that apply to IFRS Standards.

Illustrations and further practice

Notes

Questions

Chapter 15

IAS 37 and IAS 10

Outcome

By the end of this session you should be able to:

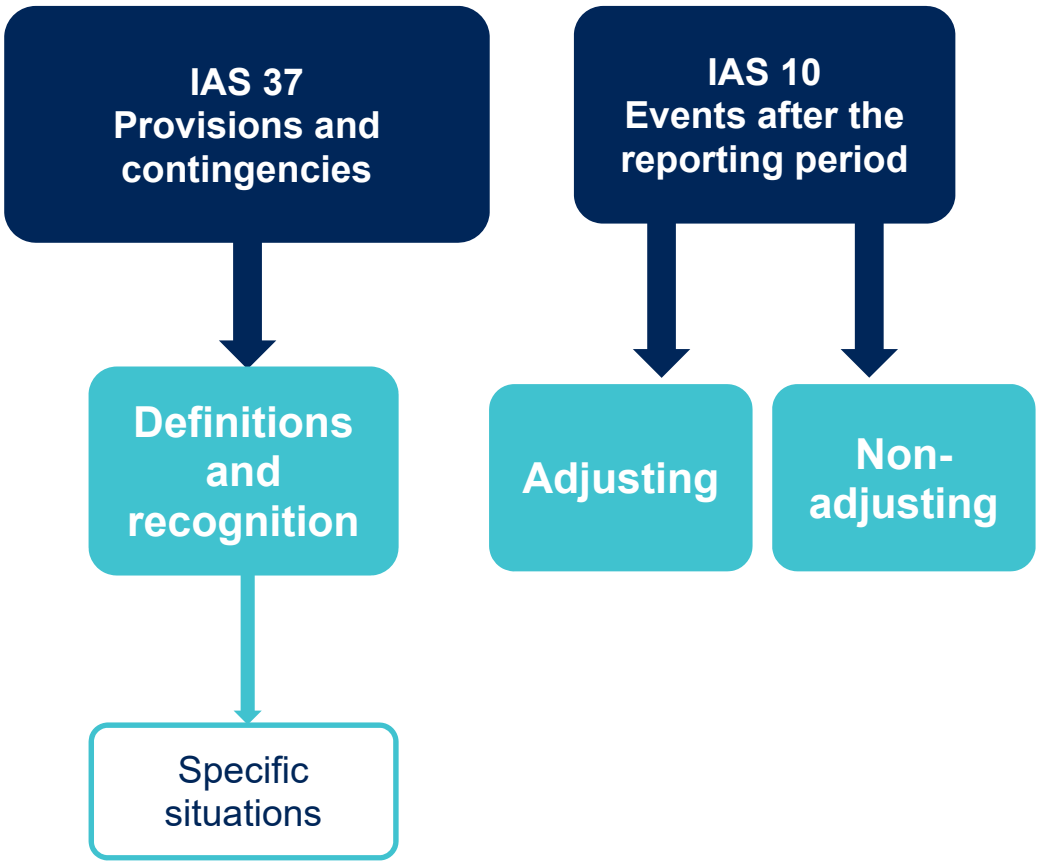
- explain why an accounting standard on provisions is necessary
- distinguish between legal and constructive obligations
- explain when provisions may be recognised and how they should be measured and accounted for
- define and account for contingent liabilities and contingent assets
- distinguish between and account for adjusting and non-adjusting events occurring after the reporting period

and answer questions relating to these areas.

PER

One of the PER performance objectives (PO6) is to record and process transactions and events. You use the right accounting treatments for transactions and events. These should be both historical and prospective – and include non-routine transactions. Working through this chapter should help you understand how to demonstrate that objective.

Overview


IAS 37
Provisions and contingencies
IAS 10
Events after the reporting period
Definitions and recognition
Specific situations
Adjusting
Non-adjusting

1 Provisions

1.1 Definitions

A **provision** is a '**liability of uncertain timing or amount**' (IAS 37, para 10).

A **liability** is a '**present obligation of the entity arising from past events the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits**' (IAS 37, para 10).

1.2 Recognition

According to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, a provision is recognised when:

- there is a present **obligation** from a past event
- there is a probable outflow of economic benefits
- the probable outflow can be measured reliably.

The accounting entry for a provision is normally:

Dr Profit or loss	**X**	
Cr Provisions (SFP)		**X**

1.3 Obligation

An obligation is something that cannot be avoided:

- a **legal obligation** arises from contracts, laws or legislation
- a **constructive obligation** arises when an entity's past practices or published policies create an expectation that it will discharge certain responsibilities.

Notes

1.4 Measurement

Provisions should be measured at the best estimate of the expenditure required to settle the obligation as at the reporting date.

The best estimate of a provision will be:

- **for a single obligation:** the most likely amount payable
- **for a large population of items**: an expected value.

If the effect of the time value of money is material, then the provision should be discounted to present value.

Illustrations and further practice

Notes

2 Specific situations

2.1 Future operating losses

An entity has no obligation to incur future operating losses and therefore, per IAS 37, no provision is recognised.

2.2 Onerous contracts

An **onerous contract** is where the unavoidable costs of the contract exceed the benefits that will be obtained.

An onerous contract is a contractual obligation that will cause a measurable outflow of economic benefits. A provision should be recorded at the **lower** of:

- the cost of fulfilling the contract
- the cost of terminating the contract.

2.3 Restructuring

An obligation to restructure a business exists if:

- there is an approved detailed plan
- employees affected are aware of the plan.

If an obligation exists, a provision should be recognised for the direct costs of the restructuring, and not for any costs of the ongoing business.

2.4 Environmental provisions

A provision will be made for future environmental costs if there is either a legal or constructive obligation to carry out the work.

Illustrations and further practice

Notes

3 Contingent liabilities and assets

3.1 Contingent liabilities

Contingent liabilities are:

- possible obligations whose existence will only be confirmed by future events not controlled by the entity, or
- present obligations where an outflow of economic benefits is not probable, or
- present obligations where the outflow of economic benefits cannot be measured.

Contingent liabilities are **disclosed** in the financial statements, unless the probability of an economic outflow is remote (in which case they are ignored).

3.2 Contingent assets

Contingent assets are:

- assets whose existence will only be confirmed by future events not controlled by the entity.

Contingent assets are **disclosed** in the financial statements if the probability of an economic inflow is **probable**.

Notes

Example 1

IAS37

Shakespeare is involved in a number of lawsuits at its year-end of 31 March 20X9. Details of three of these cases are as follows:

Shakespeare is being sued by Marlowe over copyright issues. Shakespeare has been advised that it has only 20% chance of successfully defending the case, and that the potential pay-out is $600,000.

Shakespeare is suing Hathaway for $200,000 for a breach of contract and has been advised that it has 80% chance of success.

Shakespeare is being sued for $350,000 by Claudio for selling short measures and has been advised that Claudio has only 40% chance of success.

How will the above cases be reflected within the financial statements of Shakespeare?

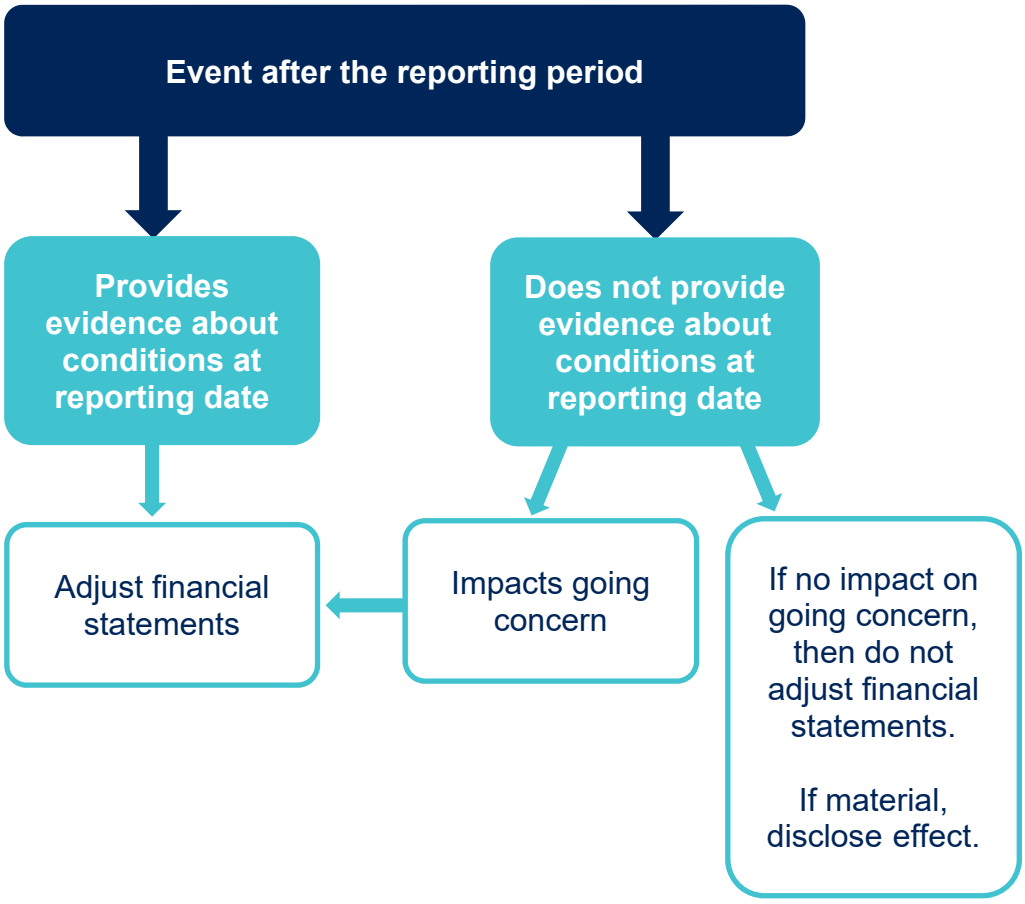
Notes

4 Events after the reporting period

4.1 Definition

An **event after the reporting period** is one which occurs between the reporting date and the date when the financial statements are authorised for issue.

4.2 Accounting for events after the reporting period


Event after the reporting period
Provides evidence about conditions at reporting date
Does not provide evidence about conditions at reporting date
Adjust financial statements
Impacts going concern
If no impact on going concern, then do not adjust financial statements.
If material, disclose effect.

Notes

Example 2

Restructuring

On 16 December 20X8 the directors of Musa approved a program of restructuring involving the redundancy of a large number of staff at a total cost of $400,000, together with the retraining of remaining staff at a cost of $200,000. Some of the remaining staff needed to be relocated at a cost of $150,000.

On 6 January 20X9, shortly after the company's year-end of 31 December 20X8, the directors announced the restructuring program to their staff, identifying those to be made redundant.

The financial controller is unsure whether the announcement on 6 January 20X9 represents an adjusting event under IAS 10 *Events After the Reporting Period*, and whether he/she should create a provision for the restructuring costs of $750,000.

Advise the Financial Controller as to whether a provision should be created.

Through your response to this requirement, this example allows you to demonstrate your knowledge of standards and principles that apply to IFRS Standards.

Notes

Questions

Chapter 16

Statement of cash flows

Outcome

By the end of this session you should be able to:

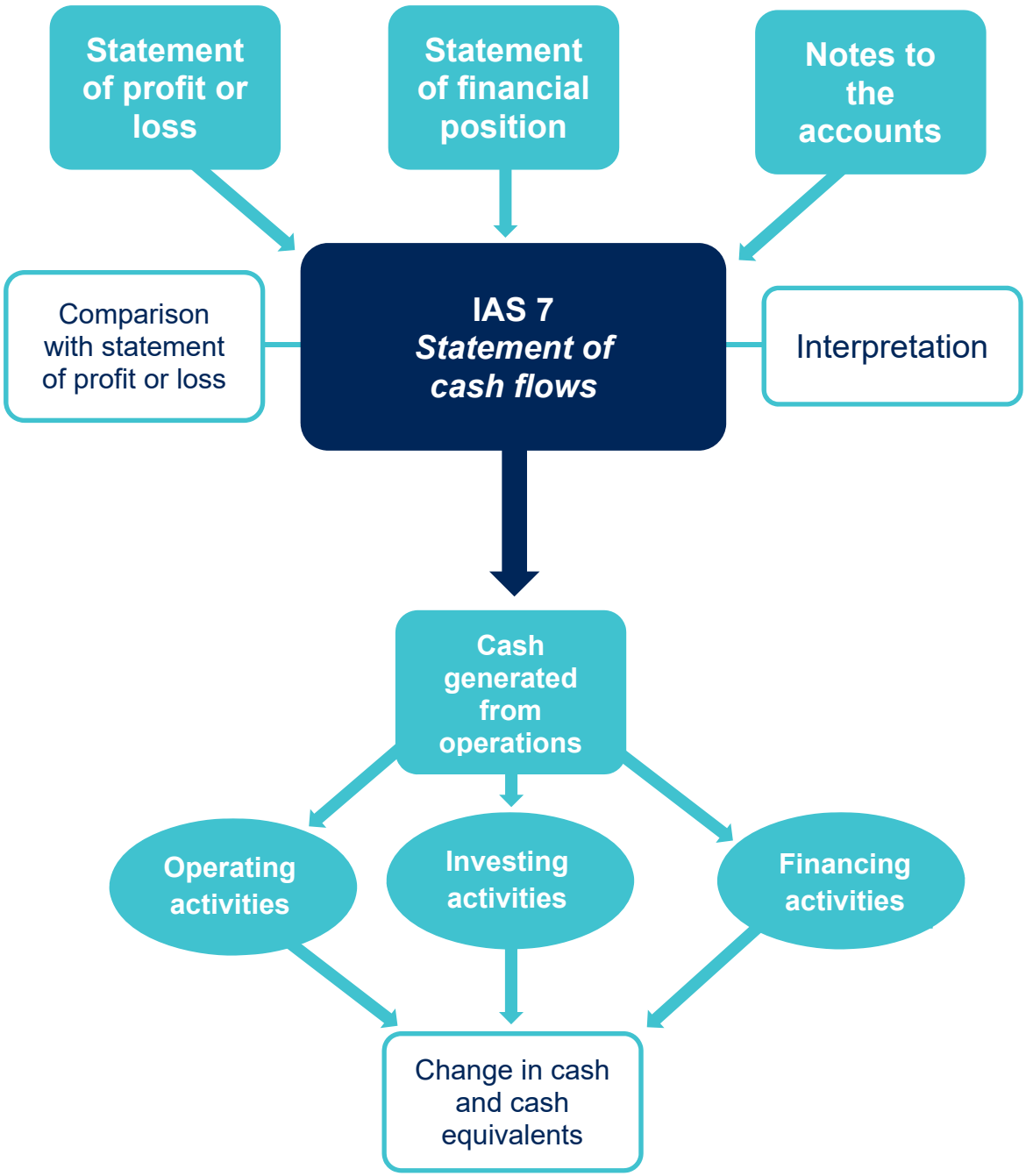
- prepare extracts from a statement of cash flows for a single entity
- compare the usefulness of cash flow information with that of a statement of profit or loss or a statement of profit or loss and other comprehensive income
- interpret a statement of cash flows to assess an entity's performance and financial position

  and answer questions relating to these areas.

PER

One of the PER performance objectives (PO7) is to prepare external financial reports. You take part in preparing and reviewing financial statements – and all accompanying information – and you do it in accordance with legal and regulatory requirements. Working through this chapter should help you understand how to demonstrate that objective.

Overview


Statement of profit or loss
Statement of financial position
Notes to the accounts
Comparison with statement of profit or loss
IAS 7 *Statement of cash flows*
Interpretation
Cash generated from operations
Operating activities
Investing activities
Financing activities
Change in cash and cash equivalents

1 Statement of cash flows

1.1 Objective of a statement of cash flows

- to ensure that all entities provide information about historical cash flows
- to classify those cash flows according to the activities which created them, either operating, investing or financing activities

1.2 Reconciliation from profit before tax to cash generated from operations

	$
Profit before tax	X
+/– Non-cash items included (e.g. depreciation)	X/(X)
+/– Non-operating items included (e.g. investment income)	X/(X)
+ Finance costs	X
+/– movements in working capital	X/(X)
Cash generated from operations	X

Illustrations and further practice

Notes

1.3 Statement of cash flows layout summary

	$
Cash generated from operations	X
Interest paid	(X)
Tax paid	(X)
Net cash from operating activities	X/(X)
Net cash from investing activities	X/(X)
Net cash from financing activities	X/(X)
Increase/decrease in cash and cash equivalents	X/(X)
Opening cash and cash equivalents	X/(X)
Closing cash and cash equivalents	X/(X)

Note that the Financial Reporting examination will not require the preparation of a complete statement of cash flows, although you may be required to prepare extracts from any part of it.

1.4 Definitions

Cash: cash on hand (including overdrafts) and on-demand deposits.

Cash equivalents: short-term highly liquid investments, subject to insignificant risk of changes in value.

Notes

1.5 Activities

Illustrations and further practice

Notes

Example 1

Cash generated from operations

Extracts from the financial statements of Danny show the following:

	20X4	
Statement of profit or loss	$	
Profit from operations	7,800	
Finance costs	(1,300)	
Investment income	400	
Profit before tax	6,900	
Income tax expense	(1,680)	
Profit for the year	5,220	

Statement of financial position	20X4	20X3
	$	$
Current assets		
Inventory	1,200	1,150
Receivables	1,760	1,820
Current liabilities		
Payables	1,380	1,200

Additional information

During 20X4 depreciation of $1,100 was charged, and Danny sold an item of plant at a profit of $600.

Calculate Danny's cash generated from operations for 20X4 using the indirect method.

Through your preparation of this calculation, this example allows you to demonstrate your knowledge of standards and principles that apply to IFRS Standards.

Notes

2 Calculating the cash flow

2.1 Principle

The cash flow for an activity is calculated using the balancing figure when comparing the opening and closing balances on the statement of financial position, adjusting for known movements through profit or loss. Various techniques may be used for this, and these are shown in the following illustration.

Notes

Illustration 1

Calculation methods

Extracts from the financial statements of West show the following:

	20X6	20X5
Statement of profit or loss	$	$
Income tax expense	(980)	(800)
Statement of financial position		
Non-current liabilities		
Deferred taxation	440	400
Current liabilities		
Taxation	900	820

Calculate the tax paid in 20X6.

When calculating cash flows for items with a current and non-current element, combine the two to calculate a single cash flow.

Method 1 – T account

Taxation

		Balance b/f: taxation	820
Balance: tax paid	**860**	deferred taxation	400
		SPL: income tax expense	980
Balance c/f: taxation	900		
deferred taxation	440		
	2,200		2,200

Method 2 – Column

	$
Balances b/f (820 + 400)	1,220
SPL: income tax expense	980
Balances c/f (900 + 440)	(1,340)
Tax paid	**860**

Method 3 – Column with balancing figure

	$
Balances b/f (820 + 400)	1,220
SPL: income tax expense	980
Tax paid (balance)	**(860)**
Balances c/f (900 + 440)	1,340

It can be seen that all three methods are in essence the same calculation, so it is a matter of personal preference as to which you choose to use.

Notes

Example 2

Cash flow calculation

Extracts from the statements of financial position of Harrad show the following:

Statement of financial position	20X9	20X8
	$	$
Non-current assets		
Property, plant and equipment	43,200	33,800
Equity		
Share capital	10,500	9,000
Share premium	2,300	1,700
Revaluation surplus	1,850	500
Non-current liabilities		
Lease payable	9,300	3,500
Current liabilities		
Lease payable	3,500	1,100

Additional information

During 20X9 depreciation of $7,200 was charged, and Harrad sold an item of plant with a carrying amount of $900 for a profit of $400.

Harrad acquired machinery under a lease agreement. At acquisition the present value of the lease payments for this machinery totalled $10,000.

The increase in revaluation surplus relates to Harrad's property which was revalued during the year. Ignore deferred taxation.

Calculate Harrad's cash flows from investing and financing activities for 20X9.

Solution

	$
Cash flows from investing activities	
Purchase of property, plant and equipment	
Sale proceeds from sale of plant	
Cash flows from financing activities	
Proceeds of share issue	
Lease liability repaid	

Illustrations and further practice

Notes

3 Cash flow information

3.1 Interpretation of statements of cash flow

When reviewing a statement of cash flow focus on the following areas:

- Cash generated from operations
- Capital expenditure
- Sources of finance
- Net cash flow

Cash generated from trading operations

When discussing this area comments should be made regarding working capital management, giving any potential reasons for movements in inventory, receivables and payables, and discussing impact on cash flow.

Capital expenditure

As sales of non-current assets are largely one-off transactions, these should be closely examined. A significant cash inflow may suggest that the company has needed to raise funds by selling assets, an inflow which is unlikely to be repeated.

The sources of finance for any additions should be considered to see whether the company has funded these from cash generated from operations or from debt/equity. If debt has been raised then regular repayments will need to be made.

Sources of finance

If new loans have been received there will be higher finance costs in future periods and regular repayments required. Conversely, if loans have been repaid, this will help cash flow in future periods.

If shares have been issued there is no requirement for this to be repaid. However, shareholders may expect regular dividends which could have to be paid indefinitely.

Net cash flow

The statement clearly shows the net cash movement for the year but it is important not to overstate the importance of this figure. A decrease in cash balances during the year may be for sound reasons (e.g. surplus cash last year) or may be the result of timing (e.g. a new loan was raised just after the end of the accounting period).

3.2 Advantages of statements of cash flow

- Helps users make judgements on future cash flows
- Indicates the relationship between profit and cash generated
- Helps users check accuracy of previous assessments
- Difficult to manipulate

3.3 Limitations of statements of cash flow

- Based on historical information, so no predictive quality
- Small scope for manipulation, e.g. delay payments at year-end
- No indication of profitability, necessary for long-term survival

Notes

Questions

Chapter 17

Principles of consolidated financial statements

Outcome

By the end of this session you should be able to:

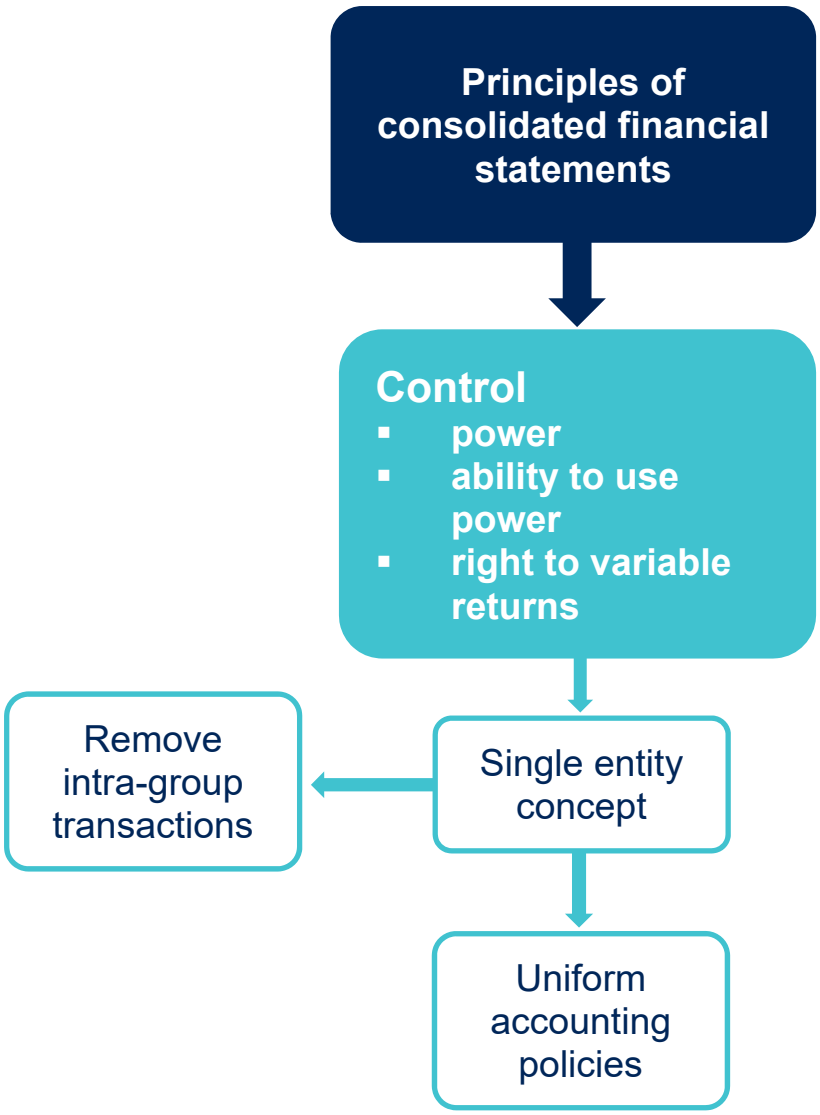
- describe the single entity concept
- explain the the elements of control
- explain why intra-group transactions need to be eliminated
- explain alternative ways to achieve control
- explain the need for uniform accounting policies

and answer questions relating to these areas.

PER

One of the PER performance objectives (PO7) is to prepare external financial reports. You take part in preparing and reviewing financial statements – and all accompanying information – and you do it in accordance with legal and regulatory requirements. Working through this chapter should help you understand how to demonstrate that objective.

Overview


Principles of consolidated financial statements
Control
power
ability to use power
right to variable returns
Single entity concept
Remove intra-group transactions
Uniform accounting policies

1 Concept of group accounts

1.1 Definitions (IFRS 10, Appendix A)

Parent – 'an entity that controls one or more entities'

Subsidiary – 'an entity that is controlled by another entity'

1.2 Control

IFRS 10 states that an investor's control comprises three elements:

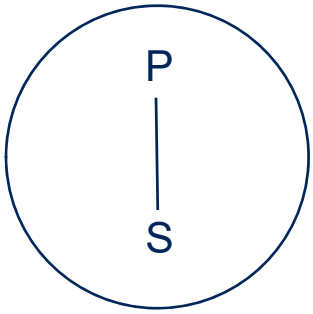
(a) power over the investee

(b) exposure, or rights to, variable returns from its involvement with the investee and

(c) the ability to use its power over the investee to affect the amount of the investor's returns' (IFRS 10, para 7).

1.3 Single entity concept

Although both the parent and subsidiary are separate legal entities, the economic substance of the relationship is that they are a single economic unit due to the fact that the parent controls the subsidiary. Within Financial Reporting the single economic unit is presented as below:



In treating the two companies as a single entity it becomes necessary to remove any intra-group transactions or balances in order to present consolidated financial statements.

Notes

1.4 Alternative sources of power

Within Financial Reporting consolidation questions the most likely source of power will be the ownership by the parent of the majority of voting shares within the subsidiary. Other sources of power include:

- contractual arrangements between the parent and other parties
- holding a minority shareholding but with the remaining equity held by a large, dispersed and unconnected group of shareholders
- potential voting rights (e.g. share options) resulting in control being gained at a specific date.

1.5 Uniform accounting policies

It is essential that consolidated financial statements are produced with uniform accounting policies throughout the group, although this does not prevent the subsidiary from applying accounting policies which differ from those of the parent within its own individual financial statements. Where the subsidiary has policies that differ from that of the group, adjustments will be necessary as part of the consolidation process to ensure consistency.

Notes

Questions

Chapter 18

Consolidated statement of financial position

Outcome

By the end of this session you should be able to:

- prepare a consolidated statement of financial position for a simple group (parent and up to two subsidiaries)
- explain and account for other reserves
- account for the effects of intra-group trading
- account for the effects of fair value adjustments
- account for goodwill impairment
- describe and apply the required accounting treatment of consolidated goodwill

and answer questions relating to these areas.

PER

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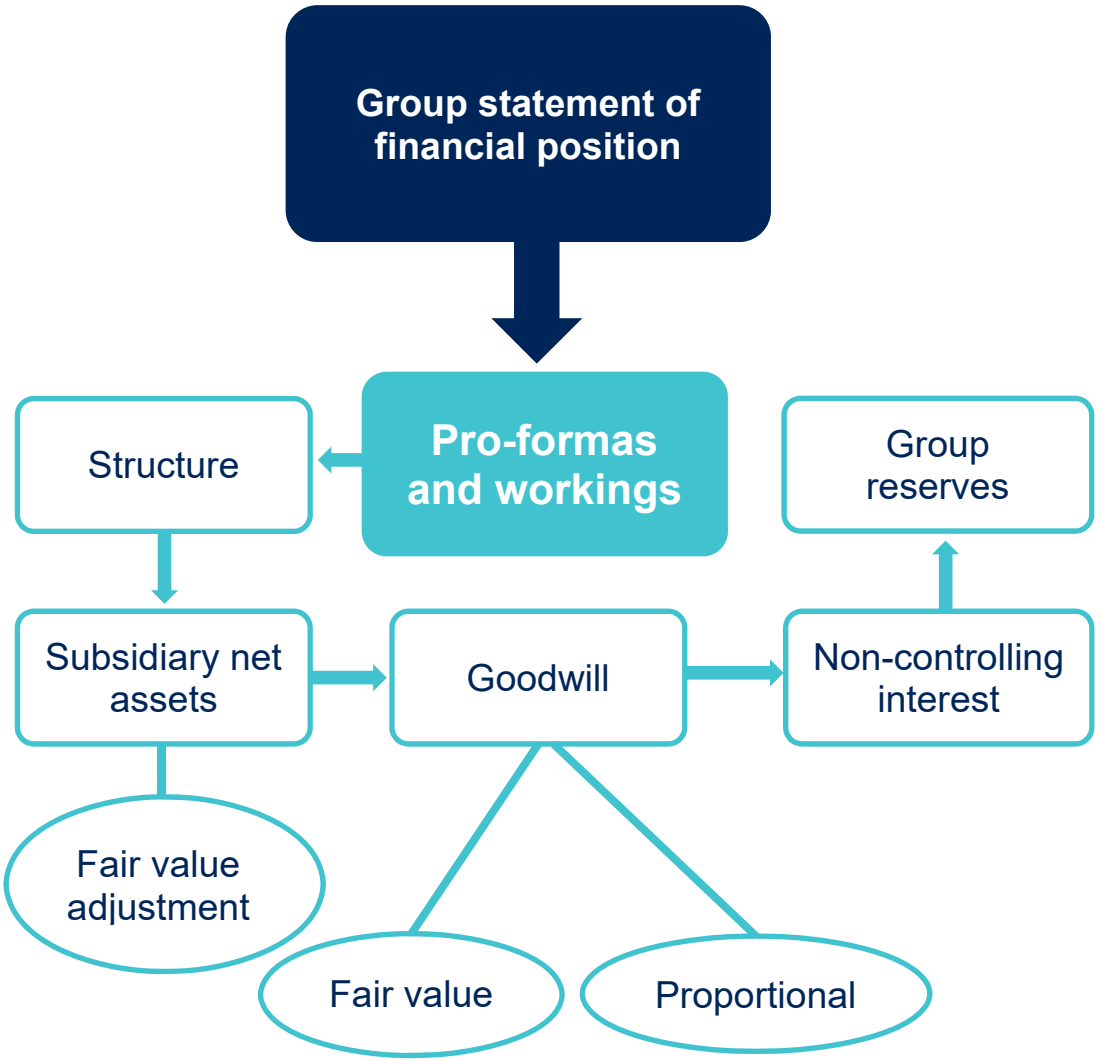
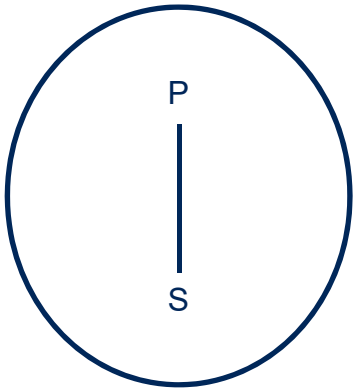

Group statement of financial position
Pro-formas and workings
Structure
Group reserves
Subsidiary net assets
Goodwill
Non-controlling interest
Fair value adjustment
Fair value
Proportional

1 Mechanics of consolidation: The standard workings

1.1 Consolidated statement of financial position standard workings

There are five standard workings when producing a consolidated statement of financial position. Note that if there are two subsidiaries then you will need to produce separate workings 2, 3 and 4 for each subsidiary, although the statement of financial position will show single combined figures for goodwill and non-controlling interest.

(W1) Group Structure



P's %

Date of acquisition

(W2) Net assets of subsidiary

	Acquisition	Reporting date	Post-acquisition
	$m	$m	$m
Share capital	X	X	
Retained earnings	X	X	X
Other components of equity	X	X	X
Fair value adjustments (FVA) (see section 2.2)	X	X	X
Post-acquisition depreciation of FVA	–	(X)	(X)
Provision for Unrealised Profit (PUP) (if S is seller, see section 3.4)	–	(X)	(X)
	X	X	X
	to W3		**to W4/W5**

The difference between reserves at the reporting date and the acquisition date (post-acquisition) is split between the group (W5) and the non-controlling interest (W4).

Fair value and PUP adjustments are explained later in the chapter.

(W3) Goodwill

	$m
Fair value of consideration	X
Non-controlling interest at acquisition (see below)	X
Subsidiary's net assets at acquisition (W2)	(X)
Goodwill at acquisition	X
Impairment	(X)
Goodwill at reporting date	X

Negative goodwill (a gain on bargain purchase) is credited to the statement of profit or loss, and therefore added to retained earnings (W5).

(W4) Non-controlling interest (NCI)

	$m
NCI at acquisition (as per W3)	X
NCI% × S's post acquisition reserves (W2)	X
NCI% × goodwill impairment (**FV method only**)	(X)
NCI at reporting date	X

(W5) Consolidated reserves

	Retained earnings	Other components
	$m	$m
100% P's reserves	X	X
P's % of S's post-acquisition reserves (W2)	X	X
Goodwill impairment	(X)	–
Gain on bargain purchase (W3)	X	–
PUP adjustment (if P was seller)	(X)	–
Reserves at reporting date	X	X

Notes

Example 1

Standard workings

On 1 April 20X6 Pepper purchased 90% of Sauce's share capital at a cost of $19 million. At this date the balance on Sauce's retained earnings was $3 million.

The statements of financial position of the two companies at 31 March 20X7 are shown below.

	Pepper	Sauce
	$000	$000
Non-current assets		
Property, plant and equipment	23,000	13,000
Investments	19,000	–
	42,000	13,000
Current assets	8,500	3,200
	50,500	16,200
Equity		
Share capital $1 ordinary shares	30,000	10,000
Retained earnings	13,100	4,200
	43,100	14,200
Current liabilities	7,400	2,000
	50,500	16,200

The following information is also relevant:

(i) Pepper values non-controlling interest using the fair value method and at the date of acquisition the non-controlling interest in Sauce was valued at $2 million.

(ii) Goodwill has been impaired by $200,000 since acquisition.

Required:

Prepare the consolidated statement of financial position for the Pepper group as at 31 March 20X7.

Through your preparation of this financial statement, this example allows you to demonstrate your knowledge of standards and principles that apply to IFRS Standards.

Solution

Pepper Group statement of financial position 31 March 20X7

	$000
Non-current assets	
Property, plant and equipment	
Goodwill (W3)	
	_____
Current assets	
	_____
	_____
Equity	
Share capital $1 ordinary shares	
Retained earnings (W5)	
	_____
Non-controlling interest (W4)	
	_____
Current liabilities	
	_____
	_____

Chapter 18

Notes

Example 2

Proportional v Fair Value method

Daniel acquired 80% of the 50,000 $1 ordinary shares of Craig on 31 December 20X6 for $78,000. At this date the net assets of Craig were $85,000.

(a) What goodwill arises on the acquisition:

(i) if the NCI is valued using the proportion of net assets method?

(ii) if the NCI is valued using the fair value method and the fair value of the NCI on the acquisition date is $19,000?

(b) Show how the fair value of the non-controlling interest could be calculated if the market price of a Craig share was $1.90 at the date of acquisition.

Through your preparation of this calculation, this example allows you to demonstrate your knowledge of standards and principles that apply to IFRS Standards.

Illustrations and further practice

Notes

2 Fair values

2.1 Fair values of consideration

When calculating goodwill in (W3), purchase consideration is measured at fair value.

Method of Payment		Measurement	Journal
Cash at acquisition		Cash paid	
Deferred cash		Present value (PV)	
Shares at acquisition		Fair value at acquisition	
Deferred shares		Fair value **at acquisition**	
Contingent consideration		Fair value The exam will provide the figure, or provide enough information to calculate it.	

Professional fees are **expensed** to profit or loss.

Notes

Example 3

Consideration

Pearson acquired 60% of the 100,000 $1 ordinary shares in Shakespeare on 1 April 20X6. The purchase consideration was made up of:

- a share exchange of two shares in Pearson for every three shares acquired in Shakespeare
- the issue of $100 10% loan notes for every 500 shares acquired and
- a deferred cash payment of $1.21 per share acquired payable on 1 April 20X8.

The value of each Pearson share at the date of acquisition was $2.20 and Pearson has a cost of capital of 10% per annum.

Required:

What is the fair value of consideration payable by Pearson?

Notes

Example 4

Consideration

P acquired 60% of S's 5,000 $1 shares on 1 July 20X7, and paid $5,000 in cash. P also issued 2 $1 shares for every 5 acquired in S and agreed to pay a further $2,000 in 3 years' time. The market value of P's shares at 1 July 20X7 was $1.80. P has only recorded the cash paid in respect of the investment in S. Current interest rates are 6%.

Required:

What is the fair value of consideration payable by P?

Through your preparation of this calculation, this example allows you to demonstrate your knowledge of standards and principles that apply to IFRS Standards.

Illustrations and further practice

Notes

2.2 Fair value of subsidiary net assets

IFRS 3 requires that the subsidiary's assets and liabilities are recorded at their fair values in order to calculate goodwill.

Where assets and liabilities are not carried at their fair value, adjustments will therefore be necessary. These will be adjusted on W2 **and** on the statement of financial position. Take care to complete **both sides** of the adjustment.

Typical fair value adjustments could include:

- Property, plant and equipment
- Inventory
- Intangible assets not recognised by the subsidiary
- Contingent liabilities

Notes

Example 5

Fair value of assets

On 1 October 20X6, Paren secured 80% of Sujay's 20,000 ordinary $1 shares.

At the date of acquisition the balance on Sujay's retained earnings was $24,000, and Sujay earned profit of a further $12,000 during the year to 30 September 20X7.

At the date of acquisition, the fair value of Sujay's property, plant and equipment was equal to its carrying amount with the exception of Sujay's plant which had a fair value of $6,000 above its carrying amount. At that date the plant had a remaining life of four years. Sujay uses straight-line depreciation for plant assuming a nil residual value.

Also at the date of acquisition, Paren valued Sujay's customer relationships as an intangible asset at a fair value of $4,500. Sujay has not accounted for this asset. Trading relationships with Sujay's customers last on average for six years.

Required:

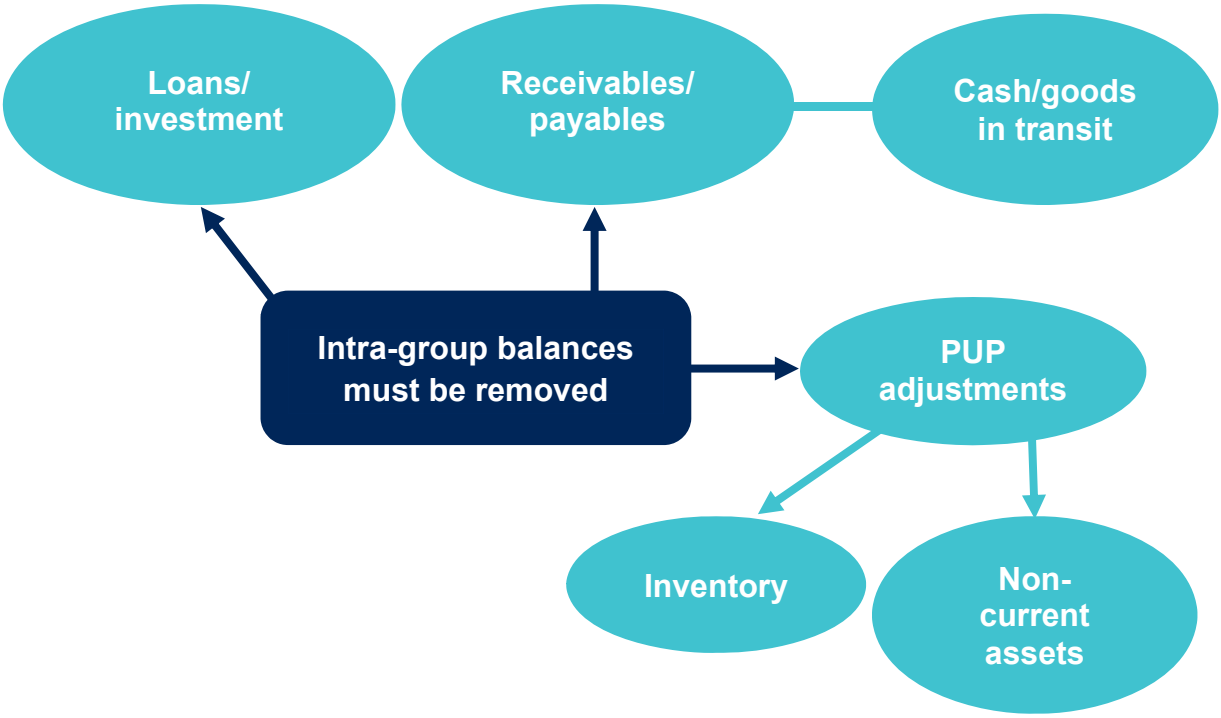
Prepare the working (W2) for Sujay's net assets for inclusion within the preparation of Paren's consolidated statement of financial position as at 30 September 20X7.

Illustrations and further practice

Notes

3 Intra-group trading

3.1 Removal of intra-group balances



3.2 Trading balances

- Remove both the asset and liability
- Where asset and liability are not equal, adjust for cash and/or goods in transit before removing the balanced asset and liability

A goods in transit adjustment will require a subsequent PUP adjustment (see below).

Notes

3.3 Cash/goods in transit

Where cash is paid or goods despatched by one group company before the reporting date but not received by the other until after the reporting date, then the intra-group balances will not agree. The adjustments necessary will amend the balances as if the cash/goods had been received, then cancel the reconciled balances.

Illustration 1

Cash/goods in transit

(i) At 28 December 20X1 the trading balances between Parent (P) and Subsidiary (S) agreed at $5,000. On that date P sent $1,000 cash to S (reducing P's payables balance to $4,000) which was not recorded by S until 2 January 20X2.

The consolidation adjustment necessary will be:

Dr Bank $1,000

Cr Receivables $1,000

The reconciled balances of $4,000 may then be cancelled.

This would be shown on the face of the statement of financial position:

Current assets	Receivables (P + S – 1,000 – 4,000)
	Bank (P + S + 1,000)
Current liabilities	Payables (P + S – 4,000)

(ii) At 28 December 20X1 the trading balances between Parent (P) and Subsidiary (S) agreed at $5,000. On that date S sent $2,000 goods to P (increasing S's receivables balance to $7,000) which was not recorded by P until 2 January 20X2.

The consolidation adjustment necessary will be:

Dr Inventory $2,000

Cr Payables $2,000

The reconciled balances of $7,000 may then be cancelled.

This would be shown on the face of the statement of financial position:

Current assets	Inventory (P + S + 2,000)
	Receivables (P + S – 7,000)
Current liabilities	Payables (P + S + 2,000 – 7,000)

Example 6

Intra-group balances

Extracts from the statements of financial position of P and S as at 30 June 20X8 are given below:

	P	S
Non-current assets	$	$
Investments	8,000	–
Current assets		
Receivables	1,400	650
Bank	600	150
Non-current liabilities		
8% loan stock	4,000	500
Current liabilities		
Payables	2,800	1,300

P paid $3,500 for its investment in the share capital of S. At the same time, P invested in 60% of S's 8% loan stock.

At the reporting date P's payables included an amount due to S of $400. This did not agree to the corresponding amount in S's financial statements of $500. The difference is explained as cash in transit.

Required:

Prepare extracts from the consolidated statement of financial position of P at 30 June 20X8.

Through your preparation of these extracts, this example allows you to demonstrate your knowledge of standards and principles that apply to IFRS Standards.

Notes

Solution

	$
Non-current assets	
Investments	
Current assets	
Receivables	
Bank	
Non-current liabilities	
8% loan stock	
Current liabilities	
Payables	

Notes

Illustrations and further practice

3.4 Provision for Unrealised Profit (PUP adjustment) – inventory

At the reporting date if a group company holds inventory that has been purchased from another group company, the profit included within that inventory is removed by means of a Provision for Unrealised Profit (PUP) adjustment. The impact is to reduce the value of inventory to its group cost and reduce the retained earnings of the selling company. If the parent is the seller reduce W5, and where the subsidiary is the seller reduce the Reporting Date column in W2.

Notes

Example 7

PUP adjustment – inventory

On 1 May 20X7 Karl bought 60% of Susan. Extracts from the statements of financial position for the two entities as at 30 November 20X7 show:

	Karl	Susan
	$	$
Current assets		
Inventory	15,000	17,000

The inventory of Karl includes $8,000 of goods purchased for cash from Susan at cost plus 25%.

Required:

Prepare extracts from the consolidated statement of financial position of Karl at 30 November 20X7.

Solution

	$
Current assets	
Inventory	

3.5 PUP adjustments – non-current assets

At the reporting date if a group company holds a non-current asset purchased from another group company, the profit included within that non-current asset needs to be removed to reduce the carrying amount of the asset to its carrying amount based on cost to the group. This achieved by means of a Provision for Unrealised Profit (PUP) adjustment, reducing the carrying amount and adjusting retained earnings.

For PUPs on non-current assets there are two adjustments to retained earnings. The seller's retained earnings are reduced by the total original profit on the asset, while the purchaser's retained earnings are increased by the value of the excess depreciation charged.

Illustration 2

PUP adjustment – non-current assets

Panya has owned 70% of the ordinary share capital of Saada for many years. On 1 January 20X6 Panya sold an item of plant to Saada for its fair value of $70,000. At this date the plant's carrying amount in Panya's accounts was $50,000, and its remaining useful life was five years.

Calculate the adjustment for unrealised profit at 31 December 20X7.

The PUP adjustment is easiest calculated by comparing the carrying amount of the plant with and without the transfer in place, calculating cumulative depreciation in each case. The value without the transfer is the value to be used in the consolidated financial statements (as this reflects the cost to the group), the difference between the two values is the PUP adjustment.

We can calculate the adjustment at 31 December 20X7 as follows:

	With transfer $	Without transfer $	Unrealised profit $
Carrying amount at 1 January 20X6	70,000	50,000	20,000
Depreciation: 2 years to 31 December 20X7 ($^2/_5$)	(28,000)	(20,000)	(8,000)
Carrying amount at 31 December 20X7	42,000	30,000	12,000

The PUP adjustment reduces the carrying amount of the plant in the consolidated statement of financial position by $12,000.

The profit element of the adjustment is in two parts. The initial profit of $20,000 is removed from the seller's (Panya's) profit (W5). The depreciation that has been charged by the buyer (Saada) in its individual financial statements is credited back into its profit in the reporting date (SFP) column of W2. Note that the adjustment to the subsidiary retained earnings will then be part of post-acquisition reserves on W2 and will effectively be split between the parent (W5) and non-controlling interest (W4).

Example 8

PUP adjustment – non-current assets

On 1 May 20X7 Karl bought 60% of Susan. Extracts from the statements of financial position for the two entities as at 30 November 20X7 show:

	Karl	Susan
	$	$
Non-current assets		
Property, plant & equipment	138,000	115,000

On 1 June 20X7 Karl transferred an item of plant to Susan for $15,000. Its carrying amount at that date was $10,000, and its remaining useful life was 5 years.

Required:

Prepare extracts from the consolidated statement of financial position of Karl at 30 November 20X7.

4 Mid-year acquisitions

4.1 Impact on standard workings

If a parent acquires a subsidiary part-way through a year, we need to calculate the subsidiary's net assets at the acquisition date for (W2), usually by taking the reporting date figure and deducting the post-acquisition profit. It is normal to assume that profits accrue evenly over the period, unless told otherwise.

Illustration 3

Mid-year acquisition

On 1 June 20X6 Panna acquired 80% of the ordinary share capital of Sema. Sema's statement of financial position as at 31 December 20X6 includes:

Equity	$
Share capital	40,000
Retained earnings	130,000

During the year to 31 December 20X6 Sema earned a profit of $36,000.

Sema's retained earnings at the acquisition date of 1 June 20X6 is calculated by deducting post-acquisition profit from retained earnings at the year-end. Post-acquisition profit, from 1 June to 31 December 20X6, is calculated as $\$36{,}000 \times {}^{7}/_{12} = \$21{,}000$.

Sema's net assets working (W2) would show:

	Acquisition $	**Reporting date $**	**Post-acquisition $**
Share capital	40,000	40,000	
Retained earnings ($130,000 – $21,000)	109,000	130,000	21,000
	149,000	170,000	21,000

Example 9

Mid-year acquisition

On 1 May 20X7 Karl bought 60% of Susan. Extracts from the statements of financial position for the two entities as at 30 November 20X7 show:

	Karl	Susan
	$	$
Equity		
Share capital	50,000	40,000
Retained earnings	189,000	69,000

Susan earned a profit of $9,000 in the year ended 30 November 20X7.

Required:

Calculate the value of Susan's net assets at the date of acquisition.

Notes

Example 10

Consolidated statement of financial position: mid-year acquisition

On 1 March 20X4, Play bought 80% of Station paying $180,000 cash on that date and agreeing to pay a further $1.21 per share on 1 March 20X6. Only the initial cash consideration has been recorded. Play has a cost of capital of 10%. The summarised statements of financial position for the two entities as at 31 December 20X4 are:

	Play	Station
	$	$
Non-current assets		
Property, plant & equipment	275,000	230,000
Investments	230,000	–
Current assets		
Inventory	30,000	35,000
Receivables	40,000	40,000
Cash	5,000	3,000
	580,000	308,000
Share capital: $1 ordinary shares	100,000	60,000
Share premium	20,000	5,000
Retained earnings	385,000	148,000
	505,000	213,000
Non-current liabilities: 6% loan notes	–	50,000
Current liabilities	75,000	45,000
	580,000	308,000

The following information is relevant:

(i) The inventory of Play includes $18,000 of goods purchased for cash from Station at cost plus 20%.

(ii) On 1 March 20X4 Play transferred an item of plant to Station for $30,000. Its carrying amount at that date was $18,000, and its remaining useful life was 5 years.

(iii) The Play Group values the non-controlling interest using the fair value method. At the date of acquisition the fair value of the 20% non-controlling interest was $55,000.

(iv) An impairment loss of $4,000 is to be charged against goodwill at the year-end.

(v) Station earned a profit of $24,000 in the year ended 31 December 20X4.

(vi) On 31 December 20X4 Play acquired 80% of Station's 6% loan notes.

(vii) Included in Play's receivables is $10,000 due from Station. Station had sent a cheque for $4,000 to Play on 29 December 20X4. Play did not receive this cheque until 2 January 20X5.

Required:

Prepare Play's consolidated statement of financial position as at 31 December 20X4.

Through your preparation of this financial statement, this example allows you to demonstrate your knowledge of standards and principles that apply to IFRS Standards.

Notes

Solution: Play Group Statement of Financial Position 31 December 20X4

	$	$
Non-current assets		
Property, plant & equipment		
Investments		
Goodwill (W3)		
		_____
Current assets		
Inventory		
Receivables		
Cash		
	_____	
		_____
		_____
Share capital: $1 ordinary shares		
Share premium		
Retained earnings (W5)		
Non-controlling interest (W4)		
		_____
Non-current liabilities:		
6% loan notes		
Deferred consideration		
Current liabilities		
		_____
		_____

Notes

Illustrations and further practice

Notes

Questions

Notes

Chapter 19

Consolidated statement of profit or loss

Outcome

By the end of this session you should be able to:

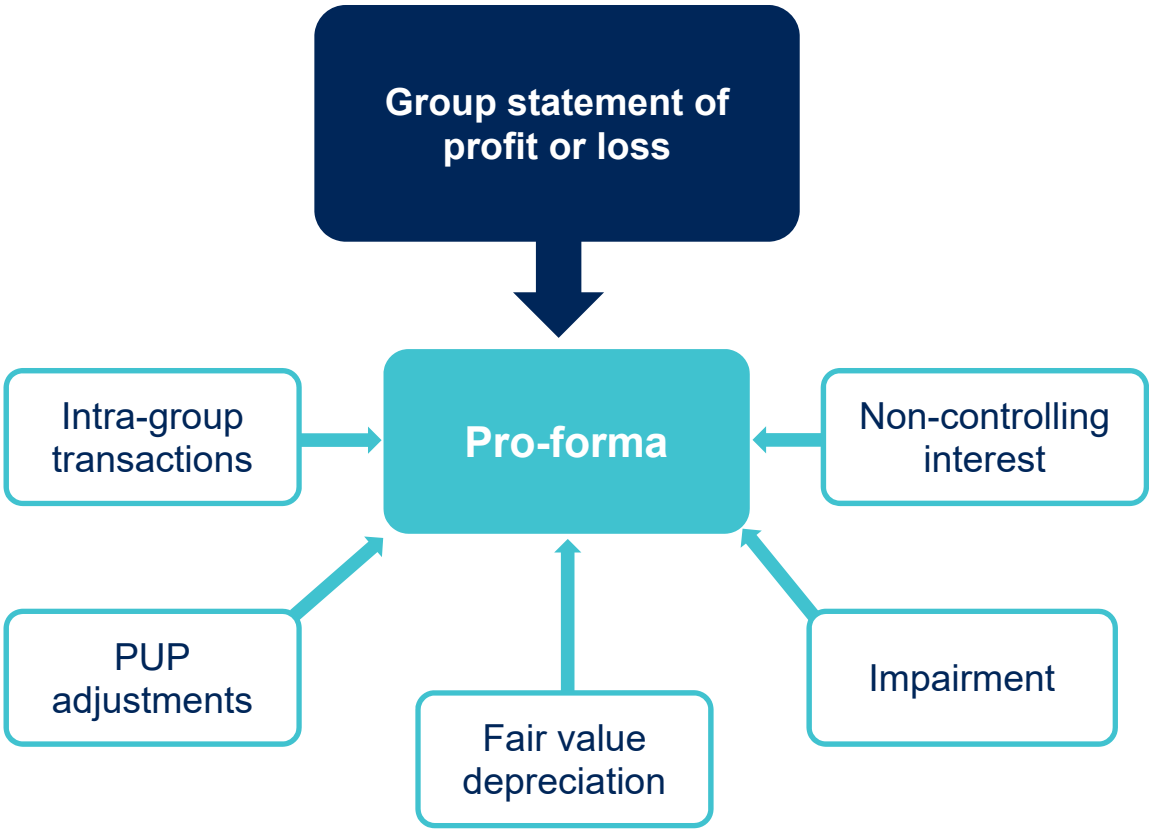
- prepare a consolidated statement of profit or loss and consolidated statement of profit or loss and other comprehensive income for a simple group, dealing with an acquisition in the period
- account for the effects of intra-group trading
- account for the effects of fair value adjustments
- account for goodwill impairment

and answer questions relating to these areas.

PER

One of the PER performance objectives (PO7) is to prepare external financial reports. You take part in preparing and reviewing financial statements – and all accompanying information – and you do it in accordance with legal and regulatory requirements. Working through this chapter should help you understand how to demonstrate that objective.

Overview


Group statement of profit or loss
Pro-forma
Intra-group transactions
Non-controlling interest
PUP adjustments
Fair value depreciation
Impairment

1 Mechanics of consolidation

1.1 Basic principles

- Combine parent and total subsidiary income, expenses and any other comprehensive income on a line-by-line basis
- Remove any intra-group items, such as trading (revenue and cost of sales) and dividends received from the subsidiary
- Make consolidation adjustments:

- Show split of profit and total comprehensive income for the year between parent and non-controlling interest.

The non-controlling interest is calculated (see below), the parent's share is the balancing figure.

Notes

1.2 Calculation of non-controlling interest

Subsidiary's profit after tax *	X	
PUP (where S is seller)	(X)	
Fair value depreciation	(X)	
Impairment (fair value method only)	(X)	
Adjusted subsidiary profit	X	× NCI% = profit attributable to NCI
Other comprehensive income	X	
Total comprehensive income (TCI)	X	× NCI% = TCI attributable to NCI

* Where acquisition takes place part-way through the current year, the subsidiary's profit after tax will represent the post-acquisition element.

Notes

Example 1

Statement of profit or loss

On 1 April 20X3 Prince purchased 75% of the equity shares in Sheena. The summarised statements of profit or loss and other comprehensive income for the two entities for the year ended 31 March 20X4 are:

	Prince	Sheena
	$	$
Revenue	450,000	240,000
Cost of sales	(260,000)	(110,000)
Gross profit	190,000	130,000
Distribution costs	(23,600)	(12,000)
Administrative expenses	(27,000)	(23,000)
Investment income	4,500	
Finance costs	(1,500)	(1,200)
Profit before tax	142,400	93,800
Income tax expense	(48,000)	(27,800)
Profit for the year	94,400	66,000
Other comprehensive income		
Gain on revaluation of land	2,500	1,000
Total comprehensive income	96,900	67,000

(i) During the year Sheena sold goods to Prince for $40,000. These goods had cost Sheena $30,000. $12,000 of these goods remained in Prince's closing inventory.

(ii) At the date of acquisition all of Sheena's assets were carried at fair value with the exception of an item of plant, whose fair value was $20,000 above its carrying amount. At this date the plant had a remaining useful life of 5 years. All depreciation is charged to cost of sales.

(iii) On 31 January 20X4 Sheena paid a dividend of $4,000.

(iv) Prince's policy is to value the non-controlling interest of Sheena at the date of acquisition at its fair value.

(v) The goodwill of Sheena has suffered impairment during the year of $5,000. Any impairment of goodwill should be accounted for as an administrative expense.

Required:

Prepare the consolidated statement of profit or loss and other comprehensive income of the Prince Group for the year ended 31 March 20X4.

Through your preparation of this financial statement, this example allows you to demonstrate your knowledge of standards and principles that apply to IFRS Standards.

Notes

Solution

Prince Group statement of profit or loss and other comprehensive income for the year ended 31 March 20X4

	$
Revenue	
Cost of sales	
Gross profit	
Distribution costs	
Administrative expenses	
Investment income	
Finance costs	
Profit before tax	
Income tax expense	
Profit for the year	
Other comprehensive income	
Gain on revaluation of land	
Total comprehensive income	
Profit for the year is attributable to:	
Owners of parent (balancing figure)	
Non-controlling interest	

Total comprehensive income is attributable to:

Illustrations and further practice

Notes

2 Mid-year acquisitions

2.1 Procedure

- When combining subsidiary performance, only include **post-acquisition revenue and expenses**
- Assume revenue and expenses accrue evenly unless told otherwise
- Where dividends have been received from the subsidiary in the post-acquisition period these should be removed from group investment income. Dividends in the pre-acquisition period will be incorporated within the calculation of net assets at acquisition
- Remove any intra-group items, such as trading (revenue and cost of sales), taking care to only exclude the post-acquisition element
- Make consolidation adjustments:

- Show split of profits and total comprehensive income between parent and non-controlling interest (NCI), taking care with NCI to only include post-acquisition elements.

Notes

Example 2

Mid-year acquisition

On 1 April 20X5 Lobster purchased 80% of the equity shares in Crab. The summarised statements of profit or loss for the two entities for the year ended 31 December 20X5 are:

	Lobster	**Crab**
	$	$
Revenue	150,000	80,000
Cost of sales	(60,000)	(52,000)
Gross profit	90,000	28,000
Operating expenses	(30,000)	(10,000)
Finance costs	(6,000)	(1,800)
Profit before tax	54,000	16,200
Income tax expense	(12,000)	(3,200)
Profit for the year	42,000	13,000

(i) During November 20X5 Crab sold goods to Lobster for $10,000 at a margin of 30%. 40% of these goods had been sold by Lobster before the year-end.

(ii) At the date of acquisition all of Crab's assets were carried at fair value with the exception of an item of plant, whose fair value was $15,000 above its carrying amount. At this date the plant had a remaining useful life of 5 years. All depreciation is charged to cost of sales.

(iii) Lobster's policy is to value the non-controlling interest of Crab at the date of acquisition at its fair value.

(iv) The goodwill of Crab has suffered impairment during the year of $3,000.

Required:

Prepare the consolidated statement of profit or loss of the Lobster Group for the year ended 31 December 20X5.

Solution

Lobster Group statement of profit or loss for the year ended 31 December 20X5

	$
Revenue	
Cost of sales	
Gross profit	
Operating expenses	
Finance costs	
Profit before tax	
Income tax expense	
Profit for the year	
Profit for the year is attributable to:	
Owners of parent (balancing figure)	
Non-controlling interest	

Example 3

Mid-year acquisition with existing subsidiary

Pari has owned 75% of the equity shares of Siya for many years. On 1 April 20X5 Pari purchased 80% of the equity shares in Mila. The summarised statements of profit or loss for the three entities for the year ended 31 December 20X5 are:

	Pari	Siya	Mila
	$	$	$
Revenue	350,000	180,000	120,000
Cost of sales	(170,000)	(80,000)	(78,000)
Gross profit	180,000	100,000	42,000
Operating expenses	(90,000)	(50,000)	(8,000)
Finance costs	(12,000)	(10,000)	(4,000)
Profit before tax	78,000	40,000	30,000
Income tax expense	(24,000)	(12,000)	(6,000)
Profit for the year	54,000	28,000	24,000

(i) During October 20X5 Mila sold goods to Pari for $20,000 at a margin of 25%. 30% of these goods had been sold by Pari before the year-end.

(ii) At the date of acquisition all of Mila's assets were carried at fair value with the exception of an item of plant, whose fair value was $16,000 above its carrying amount. At this date the plant had a remaining useful life of 4 years. All depreciation is charged to cost of sales.

(iii) Pari's policy is to value the non-controlling interest of its subsidiaries at the date of acquisition at fair value.

(iv) The goodwill of Mila has suffered impairment since acquisition of $2,000.

Required:

Prepare the consolidated statement of profit or loss of the Pari Group for the year ended 31 December 20X5.

Solution

Pari Group statement of profit or loss for the year ended 31 December 20X5

	Pari	Siya	Mila	Inter-co	Group
	$	$	$	$	$
Revenue					
Cost of sales					
Gross profit					
Operating expenses					
Finance costs					
Profit before tax					
Income tax expense					
Profit for the year					
Profit for the year is attributable to:					
Owners of parent (balancing figure)					
Non-controlling interest					

Illustrations and further practice

Notes

Questions

Chapter 20

Associates

Outcome

By the end of this session you should be able to:

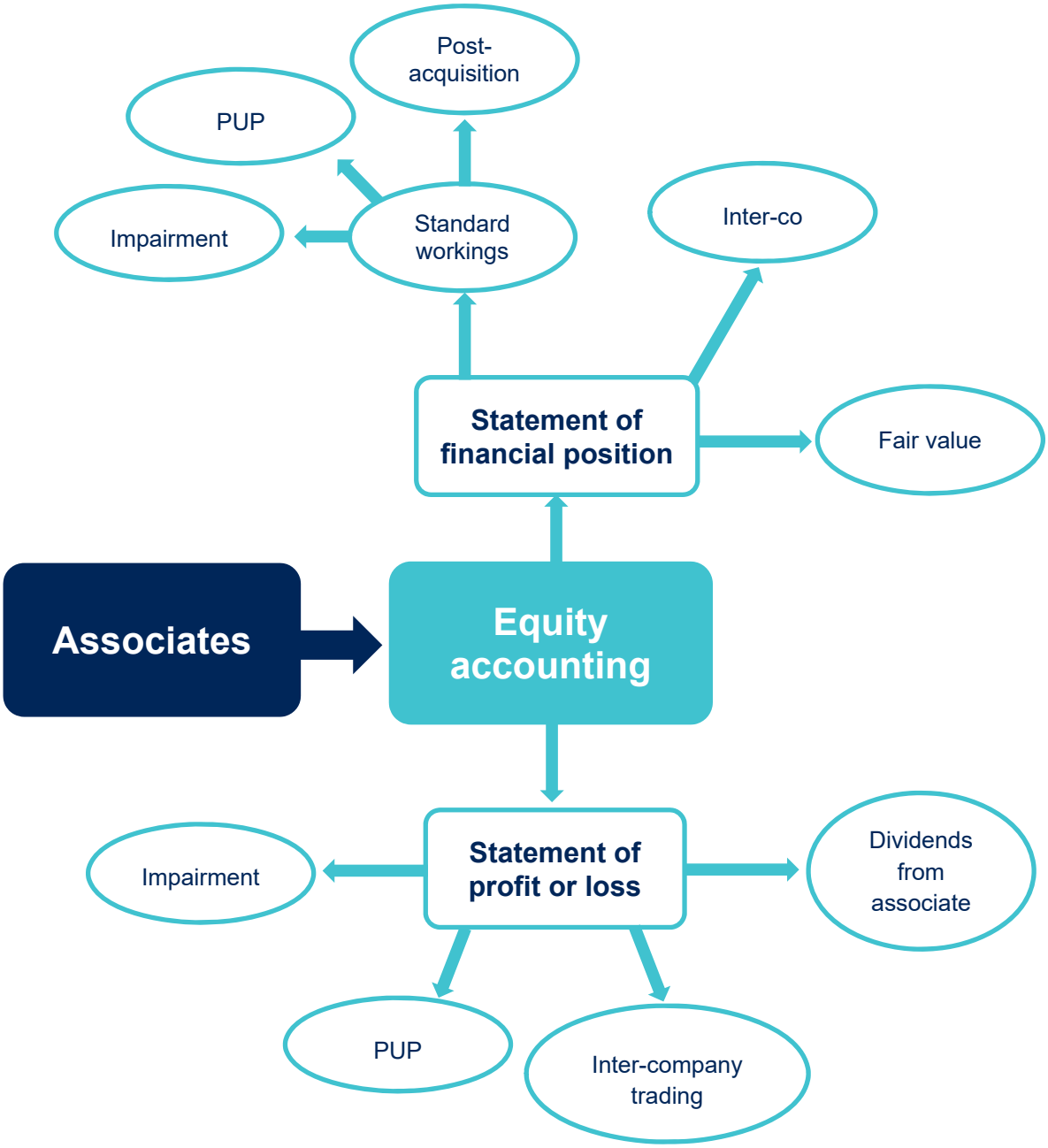
- define an associate and explain equity accounting
- prepare a consolidated statement of financial position for a simple group, including an associate
- prepare a consolidated statement of profit or loss for a simple group, including an associate

and answer questions relating to these areas.

PER

One of the PER performance objectives (PO7) is to prepare external financial reports. You take part in preparing and reviewing financial statements – and all accompanying information – and you do it in accordance with legal and regulatory requirements. Working through this chapter should help you understand how to demonstrate that objective.

Overview


Post-acquisition
PUP
Impairment
Standard workings
Inter-co
Statement of financial position
Fair value
Associates
Equity accounting
Impairment
Statement of profit or loss
Dividends from associate
PUP
Inter-company trading

1 Definitions and accounting

1.1 Definitions

- **'An associate is an entity over which the investor has significant influence'** (IAS 28, para 3).
- **'Significant influence is the power to participate in the financial and operating policy decisions of the investee'** (IAS 28, para 3).

1.2 Impact of significant influence

- Significant influence presumed where investor holds 20-50% of ordinary share capital of investee.
- Associate accounted for using **equity accounting**

1.3 Equity Accounting

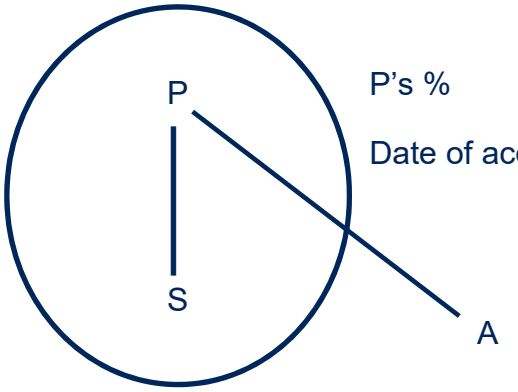
- **DO NOT** consolidate line-by-line
- **Value of investment** in associate is enhanced by parent's share of post-acquisition reserves, recognised within group reserves
- **Statement of financial position** includes single-line non-current asset 'Investment in associate' – see standard working (W6) below
- **Statement of profit or loss** includes single-line 'Share of associate profit' shown below profit from operations

Notes

1.4 Impact on standard CSFP workings

The standard workings will be used, but the addition of an associate will affect only workings 1 and 5, and require the addition of a working 6.

(W1) Group Structure



Note that the Associate (A) is outside the single entity. The Associate is not treated as a group entity, and there is no cancellation of inter-company trading or balances.

(W5) Consolidated reserves

	Retained earnings	**Other components**
	$m	$m
100% P's reserves	X	X
P's % of S's post-acquisition reserves (W2)	X	X
P's % of A's post-acquisition reserves	**X**	**X**
Goodwill impairment	(X)	–
Impairment of investment in associate	**(X)**	–
PUP adjustment (if P **or A** was seller)	**(X)**	–
Reserves at reporting date	X	X

Notes

(W6) Investment in associate

	$m
Cost of investment	X
P's % of A's post-acquisition reserves	X
Impairment of investment in associate	(X)
PUP adjustment (If **P** was the seller)	(X)
	X

These adjustments reflect the **associate** adjustments within (W5)

Notes

Example 1

Investment in associate

Papa purchased 30% of Alpha's share capital at a total cost of $8 million on 1 April 20X7, at which date the balance on Alpha's retained earnings was $4 million.

At 31 March 20X9 the balance on Alpha's retained earnings was $6 million and Papa's investment in Alpha had become impaired by $200,000.

Required:

Calculate the figure for investment in associate to be shown on Papa's consolidated statement of financial position as at 31 March 20X9.

Notes

2 Inter-company trading and fair values

2.1 Trading with the associate

- **DO NOT** eliminate balances between the associate and group companies, e.g. receivables and payables
- **DO NOT** eliminate trading between the associate and group companies, e.g. revenue and cost of sales
- Remove dividends received from associate from the statement of profit or loss
- **PUP** required where goods sold by or to associate are unsold at the year-end

2.2 Provision for unrealised profit (PUP)

- Calculated as for subsidiary but **only recognise parent's share**
- **Where P sells to A**

- **Where A sells to P**

2.3 Fair values

Where the fair values of the associate's net assets at acquisition are different to their carrying amount the net assets should be adjusted as for a subsidiary. The effects of this would include adjustments to post-acquisition earnings for fair value depreciation adjustments or similar items.

Notes

Example 2

Investment in associate

Pan purchased 40% of Apollo's share capital at a total cost of $5 million on 1 January 20X6, at which date the balance on Apollo's retained earnings was $3.6 million.

At 30 June 20X6 the balance on Apollo's retained earnings was $4.2 million and Pan's investment in Apollo had become impaired by $150,000.

During June 20X6 Pan sold goods to Apollo for $600,000 on which it made a mark-up of 20%. At 30 June 20X6 one quarter of these goods remained in Apollo's inventory.

Required:

Calculate the figure for investment in associate to be shown on Pan's consolidated statement of financial position as at 30 June 20X6.

Through your preparation of this calculation, this example allows you to demonstrate your knowledge of standards and principles that apply to IFRS Standards.

Illustrations and further practice

Notes

3 Consolidated statement of profit or loss

3.1 Single line in statement of profit or loss

The share of associate profit figure in the consolidated statement of profit or loss (CSPL) is made up as follows:

	$
Parent share of associate profit for the year	X
Impairment for the year	(X)
PUP adjustment (where A sells to P)	(X)
Share of associate profit per CSPL	X

Notes

Example 3

Share of associate profit

Pear purchased 30% of Apple's share capital on 1 January 20X6.

By 30 September 20X6 Pear's investment in Apple had become impaired by $80,000.

During September 20X6 Pear sold goods to Apple for $1.3 million on which it made a mark-up of 30%. At 30 September 20X6 half of these goods remained in Apple's inventory.

In the year to 30 September 20X6 Apple made a profit after tax of $800,000.

All items are assumed to accrue evenly throughout the year unless stated otherwise.

Required:

Calculate the figure for share of associate profit to be shown in Pear's consolidated statement of profit or loss for the year ended 30 September 20X6.

Through your preparation of this calculation, this example allows you to demonstrate your knowledge of standards and principles that apply to IFRS Standards.

Illustrations and further practice

Notes

Questions

Chapter 21

Group disposals

Outcome

By the end of this session you should be able to:

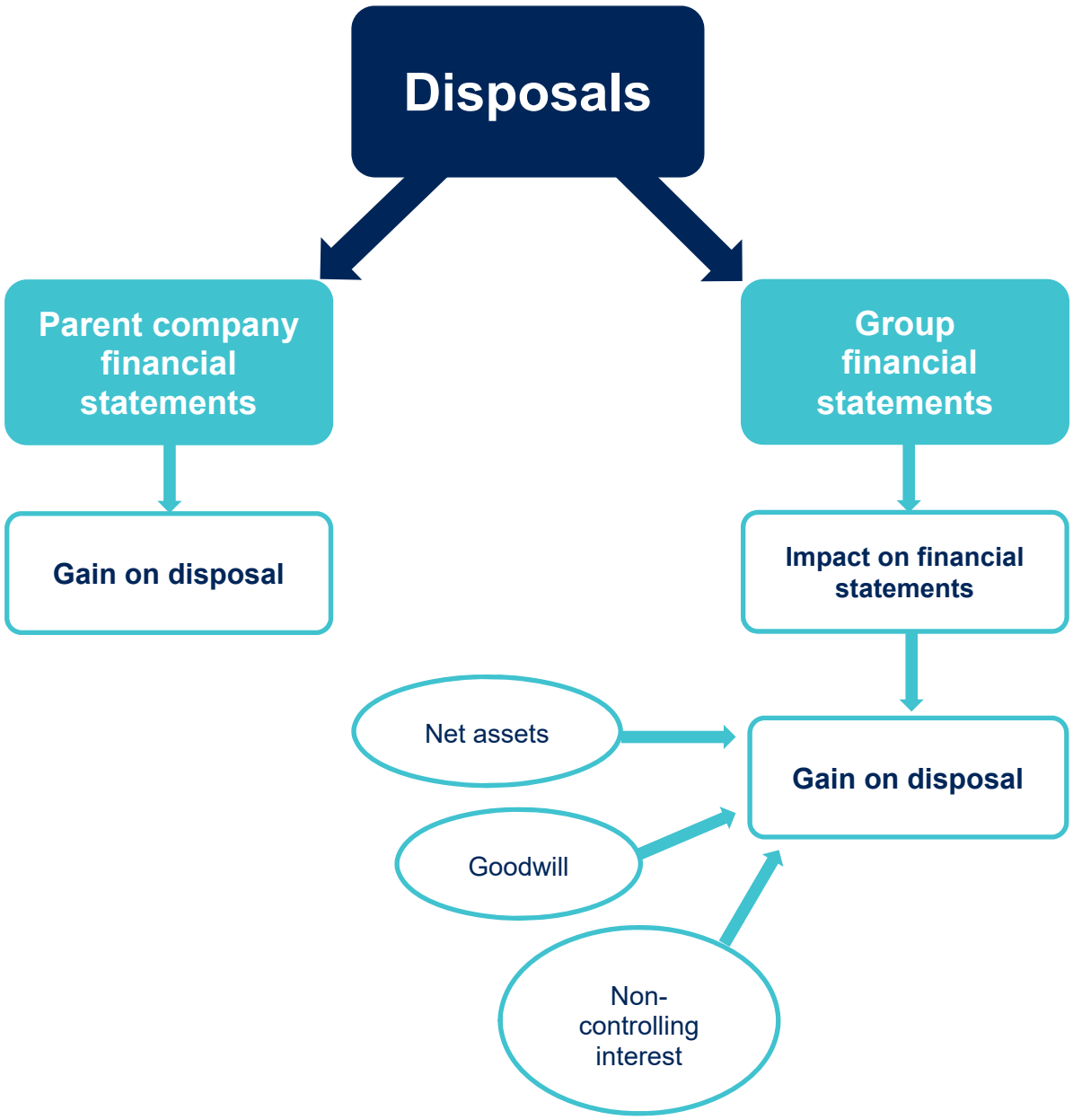
- explain and illustrate the effect of the disposal of a subsidiary in
  - the parent's individual financial statements and/or
  - the group financial statements

and answer questions relating to these areas.

PER

One of the PER performance objectives (PO6) is to record and process transactions and events. You use the right accounting treatments for transactions and events. These should be both historical and prospective – and include non-routine transactions. Working through this chapter should help you understand how to demonstrate that objective.

Overview


Disposals
Parent company financial statements
Group financial statements
Gain on disposal
Impact on financial statements
Net assets
Goodwill
Non-controlling interest
Gain on disposal

1 Disposal

1.1 Disposal

The disposal of a subsidiary needs to be reflected in

- parent individual financial statements
- group financial statements

Take care. The calculations of profit for each are very different.

Notes

2 Parent financial statements

2.1 Parent financial statement of profit or loss

	$
Sale proceeds	X
Carrying amount of investment	(X)
Profit/(loss) in parent SPL	X

2.2 Reporting

- Show separately as exceptional item on face of SPL below profit from operations
- Tax payable by parent/group is calculated on parent's profit **NOT** group profit

Notes

3 Consolidated financial statements

FR will only examine full disposal of a subsidiary, i.e. sale of all shares held by the parent.

3.1 Impact on consolidated financial statements

Statement of profit or loss

- Treat as discontinued operation (see chapter 5)
- Subsidiary results included up to date of disposal
- Profit/loss on disposal

Statement of financial position

- Subsidiary not consolidated
- Profit/loss on disposal included within retained earnings

3.2 Consolidated statement of profit or loss

		$
Sale proceeds		X
Net assets of subsidiary at disposal	X	
Net goodwill at disposal	X	
Non-controlling interest at disposal	(X)	
	——	(X)
		——
Profit/(loss) in consolidated SPL		X
		——

Notes

3.3 Calculation of values at disposal

You may be required to calculate one or more of the values in the above calculation.

Net assets

- If fair value adjustments are necessary, it may be helpful to use a standard Working 2 with columns for acquisition, disposal and post-acquisition.
- If necessary to calculate the assets due to a mid-year disposal:

	$
Net assets b/f	X
Profit/(loss) to date of disposal	X
Dividends paid prior to disposal	(X)
Net assets at disposal date	X

Goodwill

- For calculation of goodwill use a standard Working 3, remembering to deduct any impairment.

Non-controlling interest (NCI)

- For calculation of NCI use a standard SFP Working 4 to the date of disposal.

Notes

Example 1

Disposal of subsidiary

Paul acquired an 80% interest in Simonon for $6 million on 1 April 20X3, at which date Simonon's net assets had a fair value of $5 million and the fair value of the non-controlling interest was $1.2 million.

At 30 June 20X6 Paul sold all of its shares in Simonon for $8 million. At this date the fair value of Simonon's net assets was $7 million. Goodwill had been impaired by $1 million by the date of disposal.

Paul values non-controlling interest using the fair value method.

Tax on Paul's profits is charged at 30%.

Required:

Calculate the profit after tax on disposal of Simonon to be shown in

(i) Paul's individual statement of profit or loss

(ii) the Paul Group's consolidated statement of profit or loss

Notes

Example 2

Subsidiary disposal – discontinued operation

Paula has owned 75% of the equity shares of Sofia and 80% of the equity shares of Eva for many years. On 30 June 20X6 Paula sold its entire shareholding in Sofia for $8 million. The summarised statements of profit or loss for the three entities for the year ended 31 December 20X6 are:

	Paula	**Sofia**	**Eva**
	$000	$000	$000
Revenue	35,000	18,000	12,000
Cost of sales	(17,000)	(8,000)	(7,800)
Gross profit	18,000	10,000	4,200
Operating expenses	(9,000)	(5,000)	(800)
Finance costs	(1,200)	(1,000)	(400)
Profit before tax	7,800	4,000	3,000
Income tax expense	(2,400)	(1,200)	(600)
Profit for the year	5,400	2,800	2,400

(i) At the date of acquisition, goodwill in Sofia was calculated as $2 million. At 1 January 20X6 it had been impaired by $0.8 million.

(ii) At 1 January 20X6 the fair value of Sofia's net assets was $6.5 million and the fair value of the non-controlling interest in Sofia was $1.7 million.

(iii) The disposal of Sofia satisfies the conditions in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* to be treated as a discontinued operation.

(iv) No entries have been made in respect of the disposal of Sofia.

Required:

Prepare the consolidated statement of profit or loss of the Paula Group for the year ended 31 December 20X6.

Through your preparation of this financial statement, this example allows you to demonstrate your knowledge of standards and principles that apply to IFRS Standards.

Solution

Paula Group statement of profit or loss for the year ended 31 December 20X6

	Paula	Eva	Group
	$000	$000	$000
Continuing operations			
Revenue			
Cost of sales			
Gross profit			
Operating expenses			
Finance costs			
Profit before tax			
Income tax expense			
Profit for the year from continuing operations			
Profit for the year from discontinued operations			
Total profit for the year			
Profit for the year is attributable to:			
Owners of parent (balancing figure)			
Non-controlling interest			

Notes

Notes

Questions

Chapter 22

Interpretation of financial statements

Outcome

By the end of this session you should be able to:

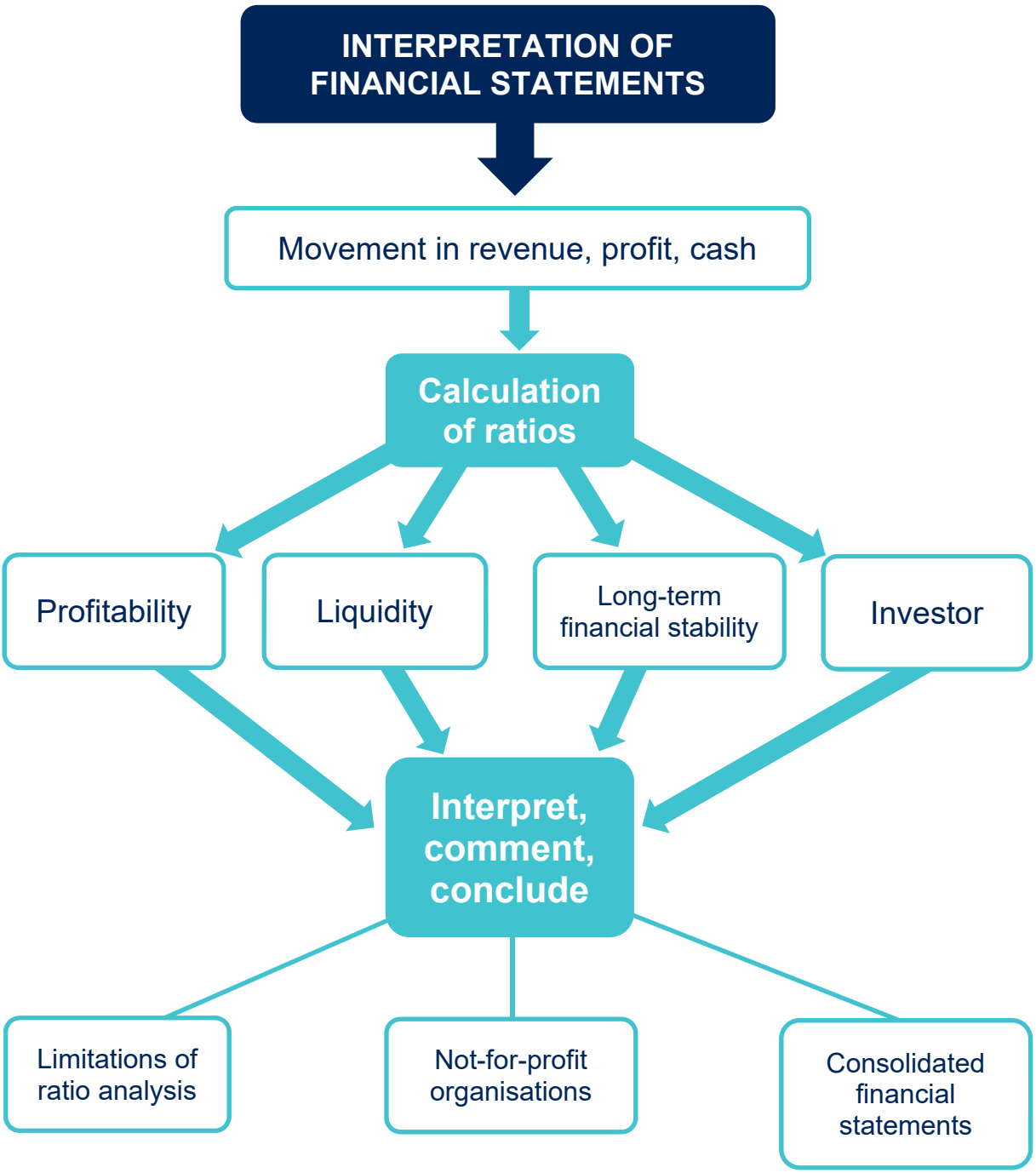
- define and compute relevant financial ratios
- interpret ratios to give an assessment of an entity/group's performance and position
- discuss the limitations of ratio analysis
- indicate other information relevant to assessing performance.

and answer questions relating to these areas.

PER

One of the PER performance objectives (PO8) is to analyse and interpret financial reports. You analyse financial statements to evaluate and assess the financial performance and position of an entity. Working through this chapter should help you understand how to demonstrate that objective.

Overview


INTERPRETATION OF FINANCIAL STATEMENTS
Movement in revenue, profit, cash
Calculation of ratios
Profitability
Liquidity
Long-term financial stability
Investor
Interpret, comment, conclude
Limitations of ratio analysis
Not-for-profit organisations
Consolidated financial statements

1 Profitability

1.1 Gross profit margin: calculation

$$\frac{\text{Gross profit}}{\text{Revenue}} \times 100\%$$

1.2 Gross profit margin: reasons for movement

1.3 Operating profit margin: calculation

$$\frac{\text{Profit from operations}}{\text{Revenue}} \times 100\%$$

1.4 Operating profit margin: reasons for movement

1.5 Asset turnover: calculation

$$\frac{\text{Revenue}}{\text{Capital employed}}$$

1.6 Asset turnover: reasons for movement

1.7 Return on capital employed (ROCE): calculation

$$\frac{\text{Profit from operations}}{\text{Capital employed}} \times 100\%$$

1.8 Return on capital employed: reasons for movement

1.9 Profitability ratio relationship

Operating profit margin	×	Asset turnover	= ROCE
Profitability	×	Efficiency	= Return

Notes

Example 1

Profitability

Extracts from the financial statements of Eden are presented below.

	20X6	20X5
Statement of profit or loss	$000	$000
Revenue	27,000	24,000
Cost of sales	(19,700)	(17,100)
Gross profit	7,300	6,900
Operating expenses	(2,300)	(1,900)
Profit from operations	5,000	5,000
Finance costs	(600)	(480)
Profit before tax	4,400	4,520
Income tax expense	(900)	(920)
Profit for the year	3,500	3,600
Statement of financial position		
Equity		
Ordinary $1 share capital	10,000	10,000
Retained earnings	9,100	6,200
	19,100	16,200
Non-current liabilities		
6% loan notes	11,000	8,000

Required:

Calculate profitability ratios for Eden for 20X5 and 20X6.

Solution

	20X6	20X5
Gross profit margin		
Operating profit margin		
Asset turnover		
Return on capital employed		

Notes

2 Liquidity

2.1 Current ratio: calculation

$$\frac{\text{Current assets}}{\text{Current liabilities}}$$

2.2 Quick ratio (or acid test): calculation

$$\frac{\text{Current assets (excluding inventory)}}{\text{Current liabilities}}$$

2.3 Current/quick ratio: reasons for movement

2.4 Inventory turnover: calculation

$$\frac{\text{Cost of sales}}{\text{Inventory}}$$

2.5 Inventory holding period: calculation

$$\frac{\text{Inventory}}{\text{Cost of sales}} \times 365 \text{ days}$$

Notes

2.6 Inventory ratios: reasons for movement

2.7 Receivables collection period: calculation

$$\frac{\text{Receivables}}{\text{Revenue}} \times 365 \text{ days}$$

2.8 Receivables collection period: reasons for movement

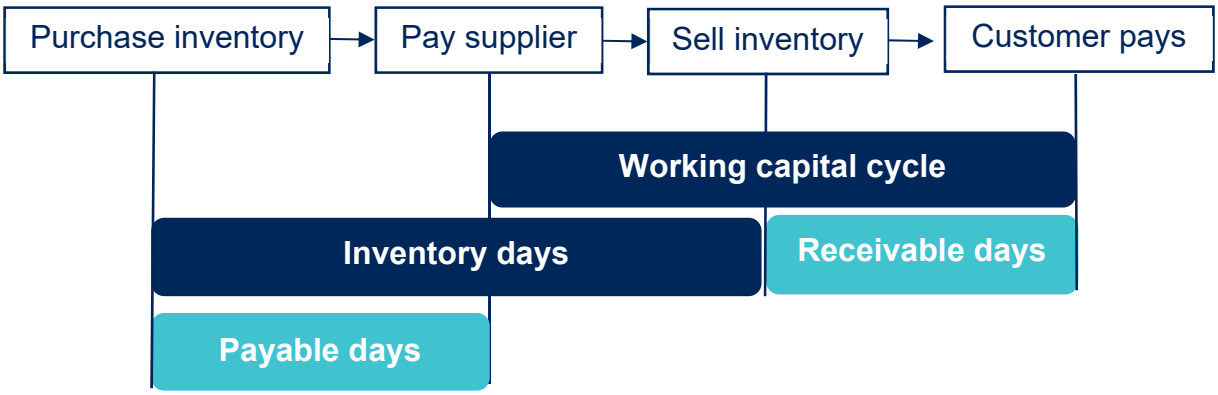
2.9 Payables payment period: calculation

$$\frac{\text{Payables}}{\text{Credit purchases}^*} \times 365 \text{ days}$$

*In the exam it is considered acceptable to substitute cost of sales for credit purchases.

2.10 Payables payment period: reasons for movement

2.11 Working capital cycle



The calculation of the working capital cycle is:

Inventory days + Receivable days – Payable days

Notes

Example 2

Liquidity

Extracts from the financial statements of Eden are presented below.

	20X6	20X5
	$000	$000
Statement of profit or loss		
Revenue	27,000	24,000
Cost of sales	(19,700)	(17,100)
Gross profit	7,300	6,900
Statement of financial position		
Current assets		
Inventory	5,100	4,600
Trade receivables	3,300	2,700
Bank	200	900
	8,600	8,200
Current liabilities		
Trade payables	3,200	2,400
Taxation	900	920
	4,100	3,320

Required:

Calculate liquidity and working capital ratios for Eden for 20X5 and 20X6.

Show your workings.

Solution

	20X6	20X5
Current ratio		
Quick ratio		
Inventory holding period		
Receivables collection period		
Payables payment period		

Notes

3 Long-term financial stability

3.1 Gearing: calculation

$$\frac{\text{Debt}}{(\text{Debt} + \text{Equity})} \times 100\%$$

3.2 Alternative gearing measure – debt: equity: calculation

$$\frac{\text{Debt}}{\text{Equity}}$$

3.3 High and low gearing

High gearing

Large proportion of fixed-return capital

Greater risk of insolvency

Proportionately greater returns to shareholders if profits are growing

Perceived as higher risk

Low gearing

Scope to increase borrowings for potential new projects

Borrow more easily

Perceived as lower risk

3.4 Gearing: reasons for movement

Increased gearing

Reduced gearing

3.5 Interest cover: calculation

$$\frac{\text{Profit before interest}}{\text{Finance costs}}$$

Notes

Example 3

Gearing and interest cover

Extracts from the financial statements of Eden are presented below.

	20X6	20X5
Statement of profit or loss	$000	$000
Profit from operations	5,000	5,000
Finance costs	(600)	(480)
Profit before tax	4,400	4,520
Income tax expense	(900)	(920)
Profit for the year	3,500	3,600
Statement of financial position		
Equity		
Ordinary share capital	10,000	10,000
Retained earnings	9,100	6,200
	19,100	16,200
Non-current liabilities		
6% loan notes	11,000	8,000

Required:

Calculate gearing and interest cover for Eden for 20X5 and 20X6.

Through your preparation of these calculations, this example allows you to demonstrate your knowledge of financial information.

Solution

	20X6	20X5
Gearing		
Interest cover		

Notes

4 Investor ratios

4.1 Earnings per share (EPS)

$$\frac{\text{Profit available to ordinary shareholders}}{\text{Number of ordinary shares}}$$

Covered in Chapter 14.

4.2 Price/Earnings (P/E) ratio

$$\frac{\text{Current share price}}{\text{Latest EPS}}$$

4.3 Dividend yield

$$\frac{\text{Dividend per share}}{\text{Current share price}}$$

4.4 Dividend cover

$$\frac{\text{Profit after tax}}{\text{Dividends}}$$

Notes

Example 4

Investor ratios

Extracts from the financial statements of Edam are presented below.

	20X6
Statement of profit or loss	$000
Profit for the year	3,500
Statement of financial position	
Equity	
Ordinary $1 share capital	10,000

Notes

Edam paid a dividend during the year of 10¢ per share, and at the year-end the market price of Edam's shares was $1.80.

There has been no change in Edam's share capital during the year.

Required:

Calculate investor ratios for Edam for 20X6.

Through your preparation of these calculations, this example allows you to demonstrate your knowledge of financial information.

Illustrations and further practice

Notes

5 Limitations of financial statements and ratio analysis

5.1 Overview of limitations

Illustrations and further practice

Notes

5.2 Non-financial information

- market share
- key employee information
- long-term management plans
- environmental and social impact
- governance

Notes

6 Specialised, not-for-profit and public sector organisations

6.1 Overview

- range of enterprises where main objective is not to earn profit
- profit-based ratios are not relevant, a better measure is value for money, which may include non-financial information

Notes

7 Consolidated financial statements

7.1 Impact on interpretation for individual entity within a group

- Intra-group transactions

- Group assets made available at subsidised rates
- Group purchasing deals available
- Intra-group arrangements distort working capital ratios.

7.2 Impact on interpretation for consolidated financial statements

- Likely to involve acquisition or disposal during year

- Need to identify impact of addition or disposal on trading performance

- Need to identify impact of subsidiary on statement of financial position.

Notes

Questions

Chapter 23

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Chapter 24

Answers

Chapter 1

Example 1

Answer pro-forma

Grey statement of profit or loss and other comprehensive income for the year ended 31 December 20X2

		$000
Revenue		95,500
Cost of sales	(62,561 + 11,250)	(73,811)
Gross profit		21,689
Distribution costs		(5,175)
Administration expenses		(6,560)
Profit from operations		9,954
Finance costs		(600)
Investment income	(750 + 150)	900
Profit before tax		10,254
Income tax expense		(2,290)
Profit for the year		7,964
Other comprehensive income	(20,000 – 15,000)	5,000
Total comprehensive income		12,964

Grey statement of changes in equity for the year ended 31 December 20X2

	Share capital	Share premium	Retained earnings	Revaluation surplus	Total equity
	$000	$000	$000	$000	$000
Balance at 1 Jan 20X2	15,000	2,000	5,175	5,000	27,175
Total comprehensive income			7,964	5,000	12,964
Dividends			(650)		(650)
Balance at 31 Dec 20X2	15,000	2,000	12,489	10,000	39,489

Grey statement of financial position as at 31 December 20X2

	$000	$000
Non-current assets		
Property plant and equipment (34,765 – 11,250 + 5,000)		28,515
Current assets		
Inventory	7,516	
Receivables	18,673	
Investments	6,500	
		32,689
		61,204

Equity		
Share capital		15,000
Share premium		2,000
Retained earnings		12,489
Revaluation surplus		10,000
		39,489
Non-current liabilities		
6% Loan		10,000
Current liabilities		
Payables	8,675	
Taxation	2,290	
Bank	750	
		11,715
		61,204

Chapter 2

Example 1

Statement of profit or loss and other comprehensive income (extract)

	$000
Depreciation (W1)	(150)
Other comprehensive income:	
Revaluation gain (W1)	5,800

Statement of financial position (extract)

Non-current assets	$000
Land and buildings (W1)	9,850
Equity	
Revaluation surplus (SOCIE)	5,730

Statement of changes in equity (extract)

	Revaluation surplus
	$000
Balance b/f	0
Revaluation gain (W1)	5,800
Transfer to retained earnings (W2)	(70)
Balance c/f	5,730

Workings

(W1)

	Land	Buildings	Total
	$000	$000	$000
Cost	1,000	4,000	5,000
Depreciation (10/50)	–	(800)	(800)
Carrying amount b/f	1,000	3,200	4,200
Revaluation gain	3,000	2,800	5,800
Revalued amount	4,000	6,000	10,000
Depreciation charge (1/40)	–	(150)	(150)
Carrying amount c/f	4,000	5,850	9,850

(W2)

		$000
New depreciation charge	As above	150
Old depreciation charge	4,000 × 1/50	(80)
Transfer to retained earnings		70

Alternatively the transfer could be calculated by dividing the revaluation surplus relating to the building by the remaining life of the asset.

$2.8m × 1/40 = $70,000

Example 2

Solution

The grant should be initially recorded as deferred income within liabilities and released over three years, meaning that $2m is taken to the statement of profit or loss each year.

This income can be shown as a separate line in the statement of profit or loss or deducted from wherever staff costs are charged.

As $2m has been released to the statement of profit or loss in 20X4, the remaining $4m will be held in deferred income, to be recognised over the next two years. Of this, $2m will be released during 20X5 so will be shown within current liabilities. The remaining $2m will be shown as a non-current liability.

Example 3

Through your preparation of these extracts, this example allows you to demonstrate your knowledge of standards and principles that apply to IFRS Standards.

	Net	Deferred credit
	$000	$000
Statement of profit or loss		
Depreciation		
((300 – 45 grant) × 20%)	(51)	
(300 × 20%)		(60)
Grant income (45 × 20%)	–	9
Statement of financial position		
Property plant & equipment		
(300 – 45 grant – 51 dep'n)	204	
(300 – 60 dep'n)		240
Non-current liability: grant	–	27
(3 years × 45 × 20%)		
Current liability: grant	–	9
(1 year × 45 × 20%)		

Example 4

Calculate the amount of interest to be capitalised in respect of the football stadium as at 31 December 20X1.

Borrowing costs should only be capitalised from 1 February 20X1, when the construction begins.

		$000
Total interest charge for the year	$10m × 6%	600
Less interest charged to profit or loss	1/12 (January)	(50)
Interest to be capitalised		550

In relation to the income earned, a similar situation applies. January's interest is earned before construction begins. Therefore this is taken as finance income to the statement of profit or loss, with the other 5 months relating to the asset.

		$000
Total interest earned on investment	$2m × 3% × 6/12	30
Less interest earned to profit or loss	1/6 (January)	(5)
Interest to be deducted from asset		25

The total that can be capitalised is the net interest incurred during the construction period, which will be $550,000 – $25,000 = $525,000

The statement of profit or loss will include finance cost of $50,000 and investment income of $5,000.

Example 5

Through your preparation of these extracts, this example allows you to demonstrate your knowledge of standards and principles that apply to IFRS Standards.

	Cost	Fair value
	$000	$000
Statement of profit or loss		
Depreciation (5,000 – 1,000) × 1/50	(80)	–
Gain on investment property (5,500 – 5,000)	–	500
Statement of financial position		
Investment property (5,000 – 80)	4,920	5,500

Chapter 3

Example 1

Solution

The development expenditure could be written off in one of two ways:

1 Amortise on a straight-line basis over four years, $400,000 × ¼ = $100,000 p.a.

2 Amortise in relation to total production:

Year 1 $400,000 × $^{3}/_{16}$ = $75,000

Year 2 $400,000 × $^{4.5}/_{16}$ = $112,500

Year 3 $400,000 × $^{6}/_{16}$ = $150,000

Year 4 $400,000 × $^{2.5}/_{16}$ = $62,500

Please note that IAS 38 suggests that amortisation based on sales revenue would not usually be appropriate, due to factors affecting revenue (e.g. inflation, pricing policy) which have no relationship to the intangible asset.

Chapter 4

Example 1

Solution

First calculate the recoverable amount. This is the higher of the fair value less costs to sell (taken here as potential sale proceeds of $15,000) and the value in use (the present value of cash flows of $19,000). The recoverable amount is therefore $19,000, which is less than the carrying amount of $42,000 and the value of the machine is thus impaired.

The impairment is calculated by deducting the recoverable amount of $19,000 from the carrying amount of $42,000 to give an impairment of $23,000.

The value of the machine is reduced to $19,000 and the impairment is charged as an expense in the statement of profit or loss.

Example 2

Identify the recoverable amount of the car and any impairment required.

Recoverable amount is higher of:

- fair value less costs to sell $3,000
- value in use $1,000

Therefore $3,000.

This indicates an impairment as follows:

	$
Carrying amount b/f	8,000
Depreciation ($8,000 × 1/8)	(1,000)
Carrying amount at date of accident	7,000
Impairment (balancing figure)	(4,000)
Recoverable amount	3,000

Example 3

Solution

The machine is initially depreciated at a rate of $3,000 ($24,000/8) per annum, leaving a carrying amount at 31 December 20X4 of $18,000 (see below). Following the impairment the carrying amount is reduced to $13,500 with a remaining useful life of six years.

The machine is then depreciated at a rate of $2,250 ($13,500/6) per annum, leaving a carrying amount at 31 December 20X6 of $9,000 (see below).

	$
Cost at 1 January 20X3	24,000
Depreciation to 31 December 20X4 ($24,000 × $^{2}/_{8}$)	(6,000)
Carrying amount at 31 December 20X4	18,000
Impairment per the question	(4,500)
Recoverable amount	13,500
Depreciation to 31 December 20X6 ($13,500 × $^{2}/_{6}$)	(4,500)
Carrying amount at 31 December 20X6	9,000

Following the impairment reversal at 31 December 20X6 the carrying amount will be increased, but the increase is restricted to the value of the depreciated original cost of the asset, calculated as $12,000 (see below). The increase in value of $3,000 ($12,000 – $9,000) is credited to the statement of profit or loss.

	$
Cost at 1 January 20X3	24,000
Depreciation to 31 December 20X6 ($24,000 × $^{4}/_{8}$)	(12,000)
Carrying amount at 31 December 20X6	12,000

Example 4

Solution

A three-column approach is a useful technique for CGU questions, with columns for carrying amount, impairment and recoverable amount.

Begin by impairing the brand, as we are told that it is to be scrapped. This leaves us with a CGU value of $1.7m ($2m – $0.3m). Complete the carrying amount column with the figures from the question, totalling $1.7m, then enter the total for the recoverable amount ($1.17m) and the impairment of $0.53m ($1.7m – $1.17m).

The other net assets remain unimpaired as they are already held at their recoverable amount. Allocate the impairment as follows:

1 Goodwill, impaired by $180k

2 Remaining impairment of $350k (830 – 300 – 180) allocated against remaining assets (machinery, land and buildings) pro-rata based on their carrying amount (see working below).

	Carrying amount	Impairment	Recoverable amount
	$000	$000	$000
Machinery	500	125[2]	375
Goodwill	180	180[1]	–
Land and buildings	900	225[2]	675
Brand	–	–	–
Other net assets	120	–	120
Total	1,700	530	1,170

The remaining impairment of $350k is allocated between machinery and land and buildings. Total carrying amount for these assets is $1,400k (500k + 900k), so each asset category is impaired by $^{350}/_{1,400}$ of its carrying amount.

Machinery: $500 \times {}^{350}/_{1,400} = \$125k$

Land and buildings: $900 \times {}^{350}/_{1,400} = \$225k$

Chapter 5

Example 1

Solution

The machine is depreciated during the year up to the date of reclassification. At this date depreciation ceases, and the asset is then valued at the lower of carrying amount and fair value less costs to sell.

Statement of profit or loss year ended 31 December 20X5

		$
Depreciation	(W1)	(12,500)
Impairment	(W2)	(1,150)

Statement of financial position 31 December 20X5

	$
Current assets: Asset held for sale (W2)	31,350

(W1) Carrying Amount

	$
1 January 20X4 Cost	60,000
Depreciation: 20X4 $60,000 × ¼	(15,000)
20X5 $60,000 × ¼ × $^{10}/_{12}$	(12,500)
31 October 20X5 Carrying Amount	32,500

(W2) Impairment

	$
Carrying Amount (W1)	32,500
Fair value less cost to sell ($33,000 less 5% commission)	(31,350)
Impairment	1,150

Example 2

Solution

Star Statement of profit or loss extract for the year ended 30 June 20X2

	$000
Profit for the year from continuing operations (W1)	1,270
Loss for the year from discontinued operations (W1)	(920)
Total profit for the year	350

(W1) Continuing/discontinued operations

		$000
Star profit after tax		350
Profit of discontinued polishing division	10	
Loss on disposal of polishing division	(230)	
Redundancy costs	(700)	
Add back: total loss from discontinued operation		920
Profit for the year from continuing operations		1,270

Chapter 9

Example 1

Solution

1 1 April 20X8 Purchase

Kr54,000 @ 1.80 = $30,000

Dr Purchases	$30,000
Cr Payables	$30,000

2 31 May 20X8 Payment

Kr54,000 @ 1.75 = $30,857 (amount paid)

Dr Payables (to clear original figure)	$30,000
Dr SPL: Exchange loss (balance)	$857
Cr Bank	$30,857

Example 2

Solution

1 1 December 20X8 Purchase

Value of goods = D60,000 @ 1.50 = $40,000

	$	$
Dr Purchases	40,000	
Cr Payables		40,000

2 31 December 20X8 retranslate payables (monetary item) at closing rate.

D60,000 @ 1.80 = $33,333. Exchange difference of $6,667 reduces payables balance and is credited to statement of profit or loss.

	$	$
Dr Payables	6,667	
Cr SPL: Exchange gain		6,667

Example 3

Solution

1 1 July 20X6 Purchase of land

Value of land = R600,000 @ 2.00 = $300,000

	$	$
Dr Land	300,000	
Cr Bank		300,000

2 31 December 20X7 revalue land to R750,000, converted at spot rate on that date.

R750,000 @ 1.50 = $500,000. Land is revalued to $500,000, with revaluation gain of $200,000 incorporating exchange difference.

	$	$
Dr Land	200,000	
Cr Other comprehensive income		200,000

Chapter 10

Example 1

Solution

Due to the length of time between the transfer of control of the asset and the payment date, this contract is deemed to include a significant financing component.

The consideration must be adjusted for the impact of the financing component. A discount rate should be used that reflects the rate available to the customer i.e. 10%.

Revenue should be recognised as the performance obligations are satisfied.

As such, revenue and a corresponding receivable should be recognised at \$826,446 (\$1 m × $1/1.1^2$) on 31 December 20X1.

In the years ending 31 December 20X2 and 20X3, as the discount is unwound, Rudd Co will recognise financing income in the statement of profit or loss. This finance income will increase the balance on receivables (Dr Receivables, Cr Finance income).

	\$
1 January 20X2 b/f	826,446
20X2 Finance income @10%	82,645
31 December 20X2 Receivable balance	909,091
20X3 Finance income @10%	90,909
31 December 20X3 Receivable balance	1,000,000

On 31 December 20X3 the balance will be received (debit bank, credit receivable), clearing the outstanding balance.

Example 2

Solution:

The selling price of the machine is $120,000 based on observable evidence.

There is no observable selling price for the technical support. Therefore, the stand-alone selling price needs to be estimated. One approach for doing this is to use the expected costs plus a margin approach. Based on this, the selling price of the service would be $30,000 ($20,000 × 150%).

The total standalone selling prices of the machine and support are $150,000 ($120,000 + $30,000). However, total consideration receivable is only $120,000. This means that the customer is receiving a discount for purchasing a bundle of goods and services of 20% ($30,000/$150,000).

IFRS 15 says that an entity must consider whether the discount relates to the whole bundle or to a particular performance obligation. In the absence of additional information, it is assumed here that it relates to the whole bundle.

The transaction price allocated to the machine is $96,000 ($120,000 × 80%).

The transaction price allocated to the technical support is $24,000 ($30,000 × 80%).

Example 3

Solution

Nim statement of profit or loss for the year ended 31 December 20X4

	$m
Revenue (30 × 66.7%(**W2**))	20
Cost of sales (per info above)	(14)
Gross profit	6

Nim statement of financial position 31 December 20X4

	$m
Current assets	
Contract asset (**W3**)	8

Workings

(W1) Contract profit

	$m	$m
Contract price		30
Costs to date	14	
Costs to complete	7	
		(21)
Contract profit		9

(W2) Stage of completion

Cost basis: cost to date/total cost	14/21	66.7%

(W3) Contract asset

	$m
Revenue recognised	20
Invoiced to customer	(12)
Contract asset per SFP	8

Example 4

Solution

Normal sales price

	$
Machine	300,000
Support $50,000 × 140% × 2 years	140,000
Total sales at full price	440,000

Actual sales price of $396,000 represents a discount of $44,000, or 10%.

This discount of 10% is applied evenly between the machine and support to give net selling prices as follows:

		$
Machine	300,000 × 90%	270,000
Support	140,000 × 90%	126,000
Total sales		396,000

Revenue for the machine may be recognised on delivery, revenue in respect of the support will be spread over the two-year period.

Revenue to be recognised in year ended 31 December 20X7:

		$
Machine	$270,000 in full	270,000
Support	$126,000 × 4/24	21,000
Total revenue recognised		291,000

Chapter 11

Example 1

The lease term is three years. This is because the option to extend the lease is reasonably certain to be exercised.

The lease liability is calculated as follows:

Date	Cash flow $	Discount rate	Present value $
31/12/X1	10,000	1/1.05	9,524
31/12/X2	10,000	$1/1.05^2$	9,070
31/12/X3	15,000	$1/1.05^3$	12,958
			31,552

The initial cost of the right-of-use asset is calculated as follows:

	$
Initial liability value	31,552
Direct costs	3,000
	34,552

The double entries to record this are as follows:

Dr Right-of-use asset	$31,552
Cr Lease liability	$31,552
Dr Right-of-use asset	$3,000
Cr Cash	$3,000

The finance cost and lease liabilities are best calculated using a lease liability table, starting with the initial value, deducting payments and charging interest as below.

Example 2

Solution

Extract from statement of profit or loss for year ended 31 March 20X8

		$
Depreciation	($750,000/4)	(187,500)
Finance cost	(W1)	(53,500)

Extract from statement of financial position 31 March 20X8

		$
Non-current assets		
Property, plant and equipment	($750,000 – $187,500)	562,500
Non-current liabilities		
Lease payable	(W1)	373,500
Current liabilities		
Lease payable	(W1)	215,000

The finance cost and lease liabilities are best calculated using a lease liability table, starting with the initial value, deducting payments and charging interest as below.

(W1)	Balance b/f	Paid	Net	Interest @ 10%	Balance c/f
31 March 20X8	750,000	(215,000)	535,000	53,500	588,500
31 March 20X9	588,500	(215,000)	373,500		
		(CL)	(NCL)		

Example 3

Solution

Extract from statement of profit or loss year ended 31 December 20X1

		$
Depreciation	(($31,552 + $3,000)/3)	(11,517)
Finance cost	(W1)	(1,578)

Extract from statement of financial position 31 December 20X1

		$
Non-current assets		
Property, plant and equipment	($31,552 + $3,000 – $11,517)	23,035
Non-current liabilities		
Lease payable	(W1)	14,287
Current liabilities		
Lease payable	($23,130 (W1) – $14,287)	8,843

The finance cost and lease liabilities are best calculated using a lease liability table, starting with the initial value, charging interest and deducting payments as below.

(W1)	Balance b/f	Interest @ 5%	Paid	Balance c/f
31 December 20X1	31,552	1,578	(10,000)	23,130
31 December 20X2	23,130	1,157	(10,000)	14,287 (NCL)

Note that the non-current liability is still calculated as the balance outstanding immediately after next year's payment has been deducted.

Example 4

The correct answer is B $18,000.

As the financial year ends on 31 March 20X3, Mayfly Co will make three lease payments (January to March) before the year end. However, the lease expense recognised in the profit or loss must include six months of expense, as the equipment has been used for six months.

The total rentals payable under the lease are $36,000 (9 months × $4,000), equal to $3,000 per month when spread over 12 months, giving an expense from 1 October 20X2 to 31 March 20X3 of **$18,000** (6 × $3,000).

The expense of $18,000 less the payments made of $12,000 would mean that the statement of financial position would show an accrual of $6,000.

Example 5

Solution

Painting needs to:

- recognise the receipt of the proceeds into the bank ($3m)
- remove the carrying amount of the machine from its assets ($1.2m)
- recognise the new right-of-use asset ($1.2m × 1.9/3 = $0.76m)
- recognise the new lease liability ($1.9m)
- recognise a profit or loss on disposal (balancing figure)

The double entry to record the transaction is:

		Dr $000	Cr $000
Dr	Bank	3,000	
Dr	Right-of-use asset	760	
Cr	Machinery		1,200
Cr	Lease liability		1,900
Cr	Profit on disposal (balance)		660

We can prove this profit by calculating the elements of the disposal.

Sale proceeds: of the $3m received we need to repay $1.9m, so sale proceeds are **$1.1m** ($3m – $1.9m),

Carrying amount: of the machinery carrying amount of $1.2m, the proportion disposed of is the above sale proceeds ($1.1m) divided by the total proceeds ($3m), so: 1.1/3 × $1.2m = $440,000.

Proof of profit:

	$000
Sale proceeds as above	1,100
Carrying amount as above	(440)
Profit on disposal as above	660

Chapter 12

Example 1

Solution

This financial liability should be measured at amortised cost. The total finance cost is equal to the total annual interest paid of $750 ($5,000 × 5% × 3 years) plus the premium on redemption of $487, giving a total cost of $1,237. This cost is spread over the three year period by using the given effective rate of interest of 8%, and is best calculated by use of an amortised cost table as shown.

	Bal b/f	Int @ 8 %	Int paid	Balance
20X5	5,000	400	(250)	5,150
20X6	5,150	412	(250)	5,312
20X7	5,312	425	(250)	5,487

The interest at 8% represents the finance cost to be shown in the statement of profit or loss each year, and the year-end balance is the balance that would be shown on the statement of financial position.

Example 2

Solution

This financial liability will initially be measured at the value of net cash received, after issue costs.

	$
Nominal value	20,000
Less 2.5% discount	(500)
Less issue costs	(534)
	18,966

The liability will be measured at amortised cost, using a table.

	Balance b/f	Interest @ 7 %	Interest paid	Balance on SFP
Year 1	18,966	1,328	(800)	19,494

The interest of $1,328 at 7% represents the finance cost to be shown in the statement of profit or loss for year 1, and the year-end balance is the balance that would be shown on the statement of financial position as a non-current liability.

Example 3

Solution

(i) The initial financial liability is to be measured at the present value of the cash flows, discounted using the market rate of interest.

N.B. Do not use the rate of interest paid to discount the payments.

Year	Cash flow		Discount factor @ 8%	Present value
20X5	Interest paid: $5,000 × 5% =	$250	0.93	233
20X6	Interest	$250	0.86	215
20X7	Interest plus capital	$5,250	0.79	4,147
		Liability		4,595

The equity balance at inception will be $5,000 – $4,595 = $405.

(ii) Extracts from the financial statements year ended 31 December 20X5

Statement of profit or loss	**$**
Finance cost ($4,595 × 8%)	(368)
Statement of financial position	**$**
Equity: conversion options	405
Non-current liability	
Convertible loan ($4,595 + $368 – $250)	4,713

Liability is measured at amortised cost, so initial value plus effective (market-rate) interest less interest paid.

Example 4

Solution

The shares are measured at Fair Value through Profit or Loss (FVPL), and revalued at the year-end with any gain or loss taken to the statement of profit or loss. The acquisition costs are immediately written off as an expense in the statement of profit or loss.

Statement of profit or loss	$
Transaction costs	(324)
Gain on FVPL investment ($2.95 – $2.70) × 6,000	1,500
Statement of financial position	
Financial asset investment ($2.95 × 6,000)	17,700

Example 5

(a) The business model is to hold the asset until redemption. Therefore, the debt instrument will be measured at amortised cost.

The asset is initially recognised at its fair value plus transaction costs of $97,000 ($95,000 + $2,000).

Interest income will be recognised in profit or loss using the effective rate of interest.

Year	b/f	Interest at 8%	Paid	c/f
20X1	97,000	7,760	(5,000)	99,760

In the year ended 31 December 20X1, interest income of $7,760 will be recognised in profit or loss and the asset will be held at $99,760 on the statement of financial position.

(b) The business model is to hold the asset until redemption, but sales may be made to invest in other assets with higher returns. Therefore, the debt instrument will be measured at fair value through other comprehensive income.

The asset is initially recognised at its fair value plus transaction costs of $97,000 ($95,000 + $2,000).

Interest income will be recognised in profit or loss using the effective rate of interest, in exactly the same way as for amortised cost.

At the end of each year the asset must be revalued to fair value. The gain will be recorded in other comprehensive income.

	b/f	Interest per (a)	Received	Net	Gain/ loss	Fair value
	$	$	$	$	$	$
20X1	97,000	7,760	(5,000)	99,760	10,240	110,000

Note that the amount recognised in profit or loss as interest income must be the same as if the asset was simply held at amortised cost. Therefore, the interest income figures are the same as in part (a).

In the year ended 31 December 20X1, interest income of $7,760 will be recognised in profit or loss and a revaluation gain of $10,240 will be recognised in other comprehensive income. The asset will be held at $110,000 on the statement of financial position.

(c) The bond would be classified as fair value through profit or loss.

The asset is initially recognised at its fair value of $95,000. The transaction costs of $2,000 would be expensed to profit or loss.

In the year ended 31 December 20X1 interest income of $5,000 ($100,000 × 5%) would be recognised in profit or loss. The asset would be revalued to $110,000 with a gain of $15,000 ($110,000 – $95,000) recognised in profit or loss.

Chapter 13

Example 1

Solution

In the year to 31 March 20X3 Wilf charged depreciation of $50,000 ($200,000 × ¼). The carrying amount of the asset at 31 March 20X3 was therefore $150,000 ($200,000 – $50,000).

In the year to 31 March 20X3 Wilf received a tax allowance in respect of the machine of the full $200,000. The tax value (cost less allowance) of the machine is therefore nil, and there is a temporary difference between the carrying amount and the tax value of $150,000, representing future depreciation which will not be offset by tax allowances.

At 31 March 20X3 Wilf needs to create a liability for deferred taxation to recognise the future liability to tax that will arise as this temporary difference reverses. The deferred tax liability is calculated by multiplying the temporary difference by the tax rate.

Wilf's deferred tax liability at 31 March 20X3 is $45,000 ($150,000 × 30%) and this is created by the following journal:

Debit income tax expense	45,000	
Credit deferred tax liability		45,000

The effect of this adjustment is to increase the tax expense and increase the deferred tax liability by $45,000.

Each year the temporary difference will be calculated and the deferred tax liability adjusted. Movements in the deferred tax liability will be reflected in the income tax expense.

At 31 March 20X4 the carrying amount of the asset reflects two years' worth of depreciation and would therefore be $100,000 ($200,000 – ($50,000 × 2)).

At 31 March 20X4 the tax value of the machine is still nil, and there is therefore a temporary difference between the carrying amount and the tax value of $100,000.

Wilf needs to adjust the liability for deferred taxation to recognise the amended liability to tax.

Wilf's deferred tax liability at 31 March 20X3 is $30,000 ($100,000 × 30%) and this is adjusted by reducing the balance from $45,000 using the following journal:

Debit deferred tax liability	15,000	
Credit income tax expense		15,000

The effect of this adjustment is to reduce the tax expense and reduce the deferred tax liability by $15,000.

Example 2

Solution:

Warranty costs are not recognised for tax purposes until paid, so the tax base of the provision is zero. The warranty costs expensed through the statement of profit or loss would be disallowed for tax purposes (as they are not yet paid), resulting in a higher taxable profit and hence a higher tax charge. This charge will be reversed in the future when the warranty costs are paid and are allowed as a tax deduction, reducing future taxable profits.

As the carrying amount of the warranty provision liability of $86,000 is greater than the tax base of zero, Kaya Co has a deductible temporary difference of $86,000, resulting in a deferred tax asset of $17,200 ($86,000 × 20%). This makes sense as we know that when the temporary difference reverses in the future, Kaya Co will benefit from a reduction in taxable profits and hence pay less tax. The double entry to recognise the asset is:

Dr Deferred tax asset (SFP)	$17,200
Cr Income tax expense (SPL)	$17,200

In subsequent years Kaya Co will recognise any increases or decreases in this asset, with the movements recognised in the statement of profit or loss.

Example 3

Solution:

The tax impact is calculated in three stages (referenced in the answer below):

1 Transfer the figures from the trial balance onto the pro-forma. In this case the debit balance for taxation forms part of the SPL tax expense for the year, and the deferred tax balance is entered onto the SFP under non-current assets.

2 Use the figure given for current year taxation to increase the tax expense in the SPL and create a current liability on the SFP.

3 Calculate the required deferred tax liability, compare it to the brought forward figure and account for the movement in SPL expense.

(W1) Deferred taxation liability at 30 September 20X9:

$63,000 × 30% = $18,900

Statement of financial position

		$
Non-current liabilities		
Deferred taxation (W1)	(17,000[1] + 1,900[3])	18,900
Current liabilities		
Taxation	(per question)	26,000[2]

Statement of profit or loss

Income tax expense	(2,200[1] + 26,000[2] + 1,900[3])	(30,100)

Example 4

Solution

The gain will be recognised by increasing the value of the land and crediting a revaluation surplus via other comprehensive income.

Dr Land	$60,000
Cr Other comprehensive income	$60,000

If this gain was realised an amount of tax would be payable on the gain, so we therefore need to create a deferred tax liability and reduce the net value of the gain. Shinji's tax rate is 30%, so the deferred tax payable would be $18,000 ($60,000 × 30%).

Dr Other comprehensive income	$18,000
Cr Deferred tax	$18,000

The impact on the financial statements is as follows:

Statement of profit or loss and other comprehensive income

		$
Other comprehensive income:		
Gain on revaluation	(60,000 – 18,000)	42,000

Statement of financial position

Equity	
Revaluation surplus	42,000
Non-current liabilities	
Deferred taxation	18,000

Chapter 14

Example 1

Solution

	No of shares	Fraction of year held	Weighted average
b/f	6,000	× 3/12	1,500
Issue	1,500		
Total	7,500	× 9/12	5,625
			7,125

Earnings per share = 1,200 ÷ 7,125 = 16.8¢

Example 2

Solution

	No of shares	Fraction of year held	Bonus fraction	Weighted average
b/f	6,000	× 3/12	(New/Old) 5/4	1,875
Bonus issue 1:4	1,500			
Total	7,500	× 9/12		5,625
				7,500

Earnings per share = 1,200 ÷ 7,500 = 16.0¢

Alternatively, treat bonus shares as in issue for whole year, and simply divide earnings by total shares, again 1,200 ÷ 7,500 = 16.0¢.

Example 3

Required:

Calculate Robert's earnings per share for the year to 31 December 20X3.

TERP calculation	No of shares	Price per share $	Total value $
Holding	4	4.00	16.00
Rights	1	2.50	2.50
	5		18.50

TERP = 18.50 ÷ 5 = $3.70

	No of shares	Fraction of year held	Rights issue bonus fraction	Weighted average
b/f	6,000	× 3/12	4/3.70	1,622
Rights issue 1:4	1,500			
Total	7,500	× 9/12		5,625
				7,247

Earnings per share = 1,200 ÷ 7,247 = 16.6¢

Example 4

Solution

Bonus fraction (1 for 4) = 5/4

Restated earnings per share = 18¢ × 4/5 = 14.4¢

Solution

Rights issue bonus fraction (as calculated in Example 3 above) = 4/3.7

Restated earnings per share = 18¢ × 3.7/4 = 16.6¢

Example 5

Solution

Basic number of shares		6,000
Conversion: $5,000 × $^{60}/_{\$100}$		3,000
Adjusted number of shares		9,000
	$	$
Basic earnings		1,200
Notional interest saved: $5,000 × 10%	500	
Tax @ 30%	(150)	
		350
		1,550

Diluted earnings per share = 1,550 ÷ 9,000 = 17.2¢

Example 6

Solution

Bonus element of options = $\frac{(1.50 - 1.20)}{1.50} \times 2{,}000 = 400$ shares

Diluted EPS = 1,200 ÷ (6,000 + 400) = 18.8¢

Chapter 15

Example 1

Solution

Marlowe has 80% chance of success, and this therefore represents a probable outflow of benefit and thus should be provided at 31 March 20X9. The value provided should represent the most likely outcome, $600,000, and will appear as a **provision** within liabilities on the statement of financial position and as an expense in the statement of profit or loss.

The Hathaway case represents a **contingent asset**, as Shakespeare has a probable inflow of benefit. Details of this situation should therefore be disclosed within the notes to the financial statements.

Shakespeare will probably win the Claudio case, but there is a possible outflow of benefit. This represents a **contingent liability** and, like the Hathaway case, details of this situation should also be disclosed within the notes to the financial statements.

Example 2

Solution

The announcement is a non-adjusting event as it does not provide evidence of a condition existing at the reporting date.

In order to create a provision there needs to be an obligation, which can either be legal or constructive. A constructive obligation would be created by communicating details of the restructuring to those affected and thus creating a valid expectation of payment. As at 31 December 20X8 Musa had not communicated details of the scheme to the employees so there would be no obligation and thus no provision.

Even if the employees involved had been informed, the provision would be restricted to the redundancy costs of $400,000, and would not include costs of the ongoing business, such as any retraining and relocation expenses.

Chapter 16

Example 1

Solution

Cash generated from operations is calculated as follows:

	20X4
	$
Profit before tax	6,900
Finance costs	1,300
Investment income	(400)
Depreciation	1,100
Profit on disposal	(600)
Increase in inventory (1,200 – 1,150)	(50)
Decrease in receivables (1,820 – 1,760)	60
Increase in payables (1,380 – 1,200)	180
Cash generated from operations	**8,490**

Example 2

Solution

	$
Cash flows from investing activities	
Purchase of property, plant and equipment (W1)	(6,150)
Sale proceeds from sale of plant ($900 + $400)	1,300
Cash flows from financing activities	
Proceeds of share issue (W2)	2,100
Lease liability repaid (W3)	(1,800)

(W1) Property, plant and equipment

Property, plant & equipment

Balance b/f	33,800	Depreciation	7,200
Revaluation (1,850 – 500)	1,350	Disposal	900
Right-of-use asset	10,000		
Purchase of assets	**6,150**	Balance c/f	43,200
	51,300		51,300

(W2) Share capital and premium

Share capital and premium

		Share capital b/f	9,000
Share capital c/f	10,500	Share premium b/f	1,700
Share premium c/f	2,300	**Share proceeds (bal)**	**2,100**
	12,800		12,800

(W3) Lease liability

Lease liability

Lease repayments (bal)	**1,800**	Balance b/f: NCL	3,500
		Balance b/f: CL	1,100
Balance c/f: NCL	9,300	New lease assets	10,000
Balance c/f: CL	3,500		
	14,600		14,600

Chapter 18

Example 1

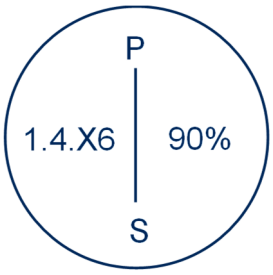
Solution

Pepper Group statement of financial position 31 March 20X7

	$000
Non-current assets	
Property, plant and equipment (23,000 + 13,000)	36,000
Goodwill (W3)	7,800
	43,800
Current assets (8,500 + 3,200)	11,700
	55,500
Equity	
Share capital $1 ordinary shares	30,000
Retained earnings (W5)	14,000
	44,000
Non-controlling interest (W4)	2,100
	46,100
Current liabilities (7,400 + 2,000)	9,400
	55,500

Workings

(W1) Structure



(W2) Net assets ($000)

	Acquisition	Reporting date	Post-acquisition
Share capital	10,000	10,000	
Retained earnings	3,000	4,200	1,200
	13,000	14,200	1,200
	(W3)		(W4)/(W5)

(W3) Goodwill

	$000
Cost of investment	19,000
Fair value of NCI	2,000
Net assets (W2)	(13,000)
Goodwill at acquisition	8,000
Impairment	(200)
Goodwill per SFP	7,800

(W4) Non-controlling interest

	$000
Value at acquisition (W3)	2,000
Post-acquisition (W2) 10% × 1,200	120
Impairment (W3) 10% × 200	(20)
	2,100

(W5) Retained earnings

	$000
Pepper 100%	13,100
Sauce (W2) 90% × 1,200	1,080
Impairment (W3) 90% × 200	(180)
	14,000

Example 2

Solution

(a)

		(i) Proportional	(ii) Fair value
		$	$
Fair value of investment		78,000	78,000
Non-controlling interest	(85,000 × 20%)	17,000	
	Fair value per Q		19,000
Net assets		(85,000)	(85,000)
Goodwill at acquisition		10,000	12,000

(b) Non-controlling interest = 50,000 × 20% × $1.90 = $19,000

Note that the NCI calculated is the same as that given in part (a). You may see either method in the exam.

Example 3

Solution

		$
Share exchange	(60% × 100,000 × $^{2}/_{3}$ x $2.20)	88,000
Loan notes	(60% × 100,000 × $^{\$100}/_{500}$)	12,000
Deferred payment	(60% × 100,000 × $1.21 × $^{1}/_{1.1^{2}}$)	60,000
	Total consideration	**$160,000**

Example 4

Solution

		$
Cash		5,000
Share exchange	(60% × 5,000 × $^{2}/_{5}$ x $1.80)	2,160
Deferred payment	($2,000 × $^{1}/_{1.06^{3}}$)	1,679
	Total consideration	**$8,839**

Example 5

Solution

	Acquisition	**Reporting date**	**Post-acquisition**
	$	$	$
Share capital	20,000	20,000	
Retained earnings	24,000	36,000	12,000
Fair value: plant	6,000	6,000	
Depreciation: ¼ × 6,000		(1,500)	(1,500)
Fair value: customer list	4,500	4,500	
Amortisation: $^{1}/_{6}$ × 4,500		(750)	(750)
	54,500	64,250	9,750

Example 6

Solution

Non-current assets		$
Investments	(8,000 – 3,500[3] – 300[4])	4,200
Current assets		
Receivables	(1,400 + 650 – 100[1] – 400[2])	1,550
Bank	(600 + 150 + 100[1])	850
Non-current liabilities		
8% loan stock	(4,000 + 500 – 300[4])	4,200
Current liabilities		
Payables	(2,800 + 1,300 – 400[2])	3,700

1 Cash in transit, calculated as the difference between the payables and receivables balances, $500 – $400 = $100.

2 Remove the balanced receivables and payables.

3 Remove the cost of investment, recorded in the goodwill calculation.

4 P's investment in S's loan stock is $500 × 60% = $300.

Example 7

Solution

		$
Current assets		
Inventory	(15,000 + 17,000 – 1,600 (W))	30,400

(W) PUP – Profit in inventory $8,000 × 25/125 = 1,600

Example 8

Solution

	$
Non-current assets	
Property, plant & equipment (138,000 + 115,000 – 4,500 (W))	248,500

(W)	**With transfer**	**Without transfer**	**PUP**
Carrying amount at transfer	15,000	10,000	5,000
Depreciation (× 1/5 × 6/12)	(1,500)	(1,000)	(500)
Carrying amount at year-end	13,500	9,000	4,500

The net adjustment of $4,500 is split between:	$
Parent retained earnings – original profit (to W5)	(5,000)
Subsidiary retained earnings – excess depreciation (to W2, SFP column)	500

Example 9

Solution

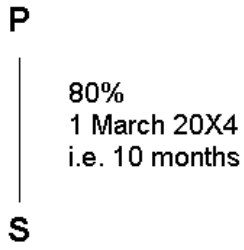
		$
Share capital		40,000
Retained earnings		
SFP date	69,000	
Less: post-acquisition \$9,000 × $^{7}/_{12}$	(5,250)	
		63,750
Net assets at date of acquisition		103,750

Example 10

Solution: Play Group Statement of Financial Position 31 December 20X4

	$	$
Non-current assets		
Property, plant & equipment (275,000 + 230,000 – 10,000 (W6))		495,000
Investments (230,000 – 180,000 – 40,000 (Loan))		10,000
Goodwill (W3)		86,000
		591,000
Current assets		
Inventory (30,000 + 35,000 – 3,000 (W2))	62,000	
Receivables (40,000 + 40,000 – 4,000(CIT) – 6,000(I/Co))	70,000	
Cash (5,000 + 3,000 + 4,000(CIT))	12,000	
		144,000
		735,000
Share capital: $1 ordinary shares		100,000
Share premium		20,000
Retained earnings (W5)		381,000
Non-controlling interest (W4)		58,000
		559,000
Non-current liabilities:		
6% loan notes (50,000 – 40,000 (Loan))		10,000
Deferred consideration (48,000 (W3) + 4,000 (W5))		52,000
Current liabilities (75,000 + 45,000 – 6,000 (I/Co))		114,000
		735,000

(W1) Structure



(W2) Net assets of Station

	Acquisition	Reporting date	Post-acquisition
	$	$	$
Share capital	60,000	60,000	
Share premium	5,000	5,000	
Retained earnings 31 December 20X4	148,000	148,000	
Less pre-acq'n ($24,000 × 10/12)	(20,000)		20,000
PUP: inventory ($18,000 × 20/120)		(3,000)	(3,000)
PUP: plant (W6)		2,000	2,000
	193,000	212,000	19,000

(W3) Goodwill	$
Parent holding at fair value	
Cash	180,000
Deferred consideration (60,000 × 80% × $1.21 × 1/1.1^2)	48,000
NCI at fair value	55,000
Net assets (W2)	(193,000)
Goodwill at acquisition	90,000
Less impairment	(4,000)
Net goodwill per SFP	86,000

(W4) Non-controlling interest	$
Value at acquisition	55,000
Impairment (4,000 × 20%)	(800)
Post-acquisition profit (W2) (19,000 × 20%)	3,800
	58,000

(W5) Retained earnings	$
Play 100%	385,000
Station (W2) (19,000 × 80%)	15,200
Impairment (4,000 × 80%)	(3,200)
Deferred acquisition interest (48,000 × 10% × 10/12)	(4,000)
PUP on plant (W6)	(12,000)
	381,000

(W6) PUP on plant

	With transfer	Without transfer	PUP
	$	$	$
Carrying amount 1 March 20X4	30,000	18,000	12,000
Depreciation (1/5 × 10/12)	(5,000)	(3,000)	(2,000)
	25,000	15,000	10,000

The net adjustment of $10,000 is split between:

Parent retained earnings – original profit (W5) ($12,000)

Subsidiary retained earnings – excess depreciation (W2) $2,000

(W7) Loan notes

80% of Station's 6% loan notes are owned by Play, included as part of Play's investments. These need to be removed from both the investments and the 6% loan notes, so we deduct $40,000 ($50,000 × 80%) from each.

(W8) Inter-company (I/Co)

After the $4,000 cash-in-transit (CIT) is processed, the remaining balance of $6,000 ($10,000 – $4,000) is removed from both receivables and payables.

Chapter 19

Example 1

Solution

Prince Group statement of profit or loss and other comprehensive income for the year ended 31 March 20X4

	$
Revenue (450 + 240 – 40)	650,000
Cost of sales (260 + 110 – 40 + 3(W1) + 4 (W2))	(337,000)
Gross profit	313,000
Distribution costs (23.6 + 12)	(35,600)
Administrative expenses (27 + 23 + 5)	(55,000)
Investment income (4.5 – 3 (W3))	1,500
Finance costs (1.5 + 1.2)	(2,700)
Profit before tax	221,200
Income tax expense (48 + 27.8)	(75,800)
Profit for the year	145,400
Other comprehensive income	
Gain on revaluation of land (2.5 + 1)	3,500
Total comprehensive income	148,900
Profit for the year is attributable to:	
Owners of parent (balancing figure)	131,900
Non-controlling interest (**W4**)	13,500
	145,400

Total comprehensive income is attributable to:	
Owners of parent (balancing figure)	135,150
Non-controlling interest (**W4**)	13,750
	148,900

(W1) PUP

$^{12}/_{40}$ × (40,000 – 30,000)	3,000
or $12,000 × 25%	

(W2) Fair value depreciation

$20,000 × $^{1}/_{5}$	4,000

(W3) Investment income

$4,000 × 75%	3,000

(W4) NCI

Sheena profit for the year	66,000
PUP (W1)	(3,000)
Fair value depreciation (W2)	(4,000)
Impairment	(5,000)
Adjusted profit for the year	54,000
Sheena other comprehensive income	1,000
Adjusted total comprehensive income (TCI)	55,000
NCI share of profit: $54,000 × 25%	13,500
NCI share of TCI: $55,000 × 25%	13,750

Example 2

	$
Revenue (150 + 60 – 10)	200,000
Cost of sales (60 + 39 – 10 + 1.8(W1) + 2.25 (**W2**))	(93,050)
Gross profit	106,950
Operating expenses (30 + 7.5 + 3)	(40,500)
Finance costs (6 + 1.35)	(7,350)
Profit before tax	59,100
Income tax expense (12 + 2.4)	(14,400)
Profit for the year	44,700
Profit for the year is attributable to:	
Owners of parent (balancing figure)	44,160
Non-controlling interest (**W3**)	540
	44,700

(W1) PUP

$10,000 × 60% × 30%	1,800

(W2) Fair value depreciation

$15,000 × $^{1}/_{5}$ × $^{9}/_{12}$	2,250

(W3) NCI

Crab profit for the year: 13,000 × $^{9}/_{12}$	9,750	
PUP (W1)	(1,800)	
Fair value depreciation (W2)	(2,250)	
Impairment	(3,000)	
Adjusted profit for the year	2,700	× 20% = 540

Example 3

Solution

Pari Group statement of profit or loss for the year ended 31 December 20X5

	Pari	Siya	Mila ($^{9}/_{12}$)	Inter-co	Group
	$	$	$	$	$
Revenue	350,000	180,000	90,000	(20,000)	600,000
Cost of sales	(170,000)	(80,000)	(58,500)	20,000	(295,000)
PUP (**W1**)			(3,500)		
FV depreciation (**W2**)			(3,000)		
Gross profit					305,000
Operating expenses	(90,000)	(50,000)	(6,000)		(148,000)
Impairment			(2,000)		
Finance costs	(12,000)	(10,000)	(3,000)		(25,000)
Profit before tax					132,000
Income tax expense	(24,000)	(12,000)	(4,500)		(40,500)
Profit for the year					91,500
Profit for the year is attributable to:					
Owners of parent (balancing figure)					82,600
Non-controlling interest (**W3**)					8,900
					91,500

(W1) PUP

$20,000 × 25% × 70%	3,500

(W2) Fair value depreciation

$16,000 × $^{1}/_{4}$ × $^{9}/_{12}$	3,000

(W3) NCI

	$		$
Siya			
Profit for the year	28,000	× 25%	7,000
Mila			
Profit for the year: 24,000 × $^{9}/_{12}$	18,000		
PUP (**W1**)	(3,500)		
Fair value depreciation (**W2**)	(3,000)		
Impairment	(2,000)		
Adjusted profit for the year	9,500	× 20%	1,900
			8,900

Chapter 20

Example 1

Solution:

	$000
Cost of investment	8,000
Papa's share of Alpha post-acquisition reserves ($6m – $4m) × 30%	600[1]
Impairment	(200)[1]
Investment in associate	**8,400**

Note[1] that the other side of the entry is to group retained earnings (W5).

Note also that impairment in the investment is charged in full. It is the parent's investment that is being impaired, rather than the associate in which the parent holds a 30% investment.

Example 2

Solution:

	$000
Cost of investment	5,000
Pan's share of Apollo post-acquisition reserves ($4.2m – $3.6m) × 40%	240[1]
Impairment as above	(150)[1]
PUP adjustment ($600,000 × $^{20}/_{120}$ × ¼ × 40%)	(10)[1]
Investment in associate	**5,080**

Note[1] that the other side of the entry is to group retained earnings (W5).

Example 3

Solution:

	$000
Share of profit ($800,000 × $^{9}/_{12}$ × 30%)	180
Impairment per question	(80)
Share of associate profit	**100**

Note that the PUP adjustment increases group cost of sales because Pear is selling to Apple.

Chapter 21

Example 1

Solution:

(i) Individual statement of profit or loss

	$000
Sale proceeds	8,000
Carrying amount of investment	(6,000)
Profit on disposal	2,000
Tax at 30%	(600)
Profit after tax	**1,400**

(ii) Consolidated statement of profit or loss

	$000	$000
Sale proceeds		8,000
Net assets at disposal	7,000	
Goodwill at disposal (W1)	1,200	
NCI at disposal (W2)	(1,400)	
		(6,800)
Profit on disposal		1,200
Tax (per part (i) **DO NOT RECALCULATE**)		(600)
Profit after tax		**600**

(W1) Goodwill

	$000
Cost of investment	6,000
Fair value of NCI	1,200
Net assets at acquisition	(5,000)
Gooodwill at acquisition	2,200
Impairment per question	(1,000)
Goodwill at disposal	1,200

(W2) Non-controlling interest

	$000
Value at acquisition (W1)	1,200
Impairment (1,000 × 20%)	(200)
Post-acquisition profit (7,000 – 5,000) × 20%	400
	1,400

Example 2

Solution

Paula Group statement of profit or loss for the year ended 31 December 20X6

	Paula	Eva	Group
	$000	$000	$000
Continuing operations			
Revenue	35,000	12,000	47,000
Cost of sales	(17,000)	(7,800)	(24,800)
Gross profit			22,200
Operating expenses	(9,000)	(800)	(9,800)
Finance costs	(1,200)	(400)	(1,600)
Profit before tax			10,800
Income tax expense	(2,400)	(600)	(3,000)
Profit for the year from continuing operations			7,800
Profit for the year from discontinued operations (**W2**)			2,350
Total profit for the year			10,150
Profit for the year is attributable to:			
Owners of parent (balancing figure)			9,320
Non-controlling interest (**W3**)			830
			10,150

(**W1**) Profit on disposal of subsidiary

	$000	$000
Sale proceeds		8,000
Net assets (6,500 + (2,800 × $^{6}/_{12}$))	7,900	
Goodwill (2,000 – 800)	1,200	
Non-controlling interest (1,700 +(2,800 × $^{6}/_{12}$ × 25%))	(2,050)	
		(7,050)
Profit on disposal		950

(**W2**) Profit from discontinued operation

	$000
Sofia profit to date of disposal:	
$2,800 × $^{6}/_{12}$	1,400
Profit on disposal (**W1**)	950
Profit from discontinued operation	2,350

(**W3**) Non-controlling interest

	$000		$000
Sofia profit to date of disposal:			
$2,800 × $^{6}/_{12}$	1,400	× 25%	350
Eva profit for the year	2,400	× 20%	480
Non-controlling interest			830

Chapter 22

Example 1

Solution

	20X6		20X5
Gross profit margin			
Gross profit/revenue			
(7,300/27,000)	27.0%	(6,900/24,000)	28.8%
Operating profit margin			
Operating profit/revenue			
(5,000/27,000)	18.5%	(5,000/24,000)	20.8%
Asset turnover			
Revenue/capital employed			
(27,000/ (19,100 + 11,000))	0.9 times	(24,000/ (16,200 + 8,000))	1.0 times
Return on capital employed			
Operating profit/capital employed			
(5,000/ (19,100 + 11,000))	16.6%	(5,000/ (16,200 + 8,000))	20.7%

Example 2

Solution

	20X6		20X5
Current ratio			
Current assets/current liabilities			
(8,600/4,100)	2.1	(8,200/3,320)	2.5
Quick ratio			
Current assets (exc inventory)/current liabilities			
(3,500/4,100)	0.9	(3,600/3,320)	1.1
Inventory holding period			
(Inventory/cost of sales) × 365			
(5,100/19,700) × 365	94 days	(4,600/17,100) × 365	98 days
Receivables collection period			
(Receivables/revenue) × 365			
(3,300/27,000) × 365	45 days	(2,700/24,000) × 365	41 days
Payables payment period			
(Payables/cost of sales) × 365			
(3,200/19,700) × 365	59 days	(2,400/17,100) × 365	51 days

Example 3

Solution

		20X6		20X5
Gearing				
Debt/(debt + equity)				
	(11,000/ (11,000 + 19,100)	36.5%	(8,000/ (8,000 + 16,200)	33.1%
Interest cover				
Profit from operations/finance costs				
	(5,000/600)	8.3	(5,000/480)	10.4

Example 4

Solution

Earnings per share	3,500/10,000	35.0¢
Profit for year/no of shares		
Price/Earnings ratio	180/35	5.1
Share price/EPS		
Dividend yield	10/180	5.6%
Dividend per share/share price		
Dividend cover (EPS/divi per share)	35/10	3.5
Or Profit for year/total dividend	Or 3,500/(10,000 × 10¢)	